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CANADIAN NATIONAL
ANNUAL REPORT 1989

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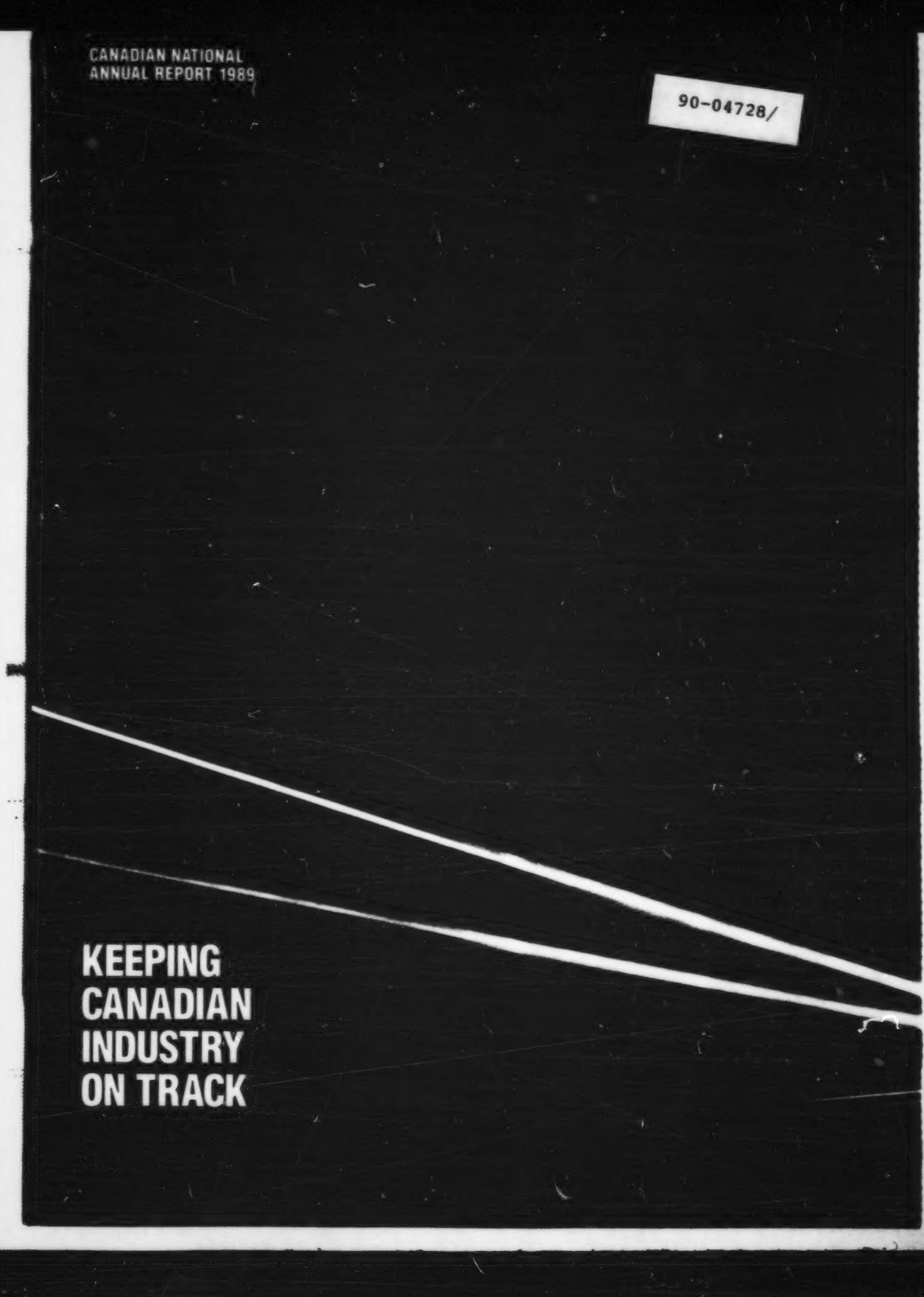


KEEPING CANADIAN INDUSTRY ON TRACK

Canadian National offers rail-based freight transportation and distribution services throughout Canada and into the United States. Its primary role is to help Canadian industry grow in the global marketplace by providing efficient, high-quality product distribution.

CN's customers, some of whom are featured in this report, come from almost every sector of the Canadian economy and every region of the country. CN and its employees are dedicated to keeping Canadian industry on track.

Incorporated in 1919 as a commercial Crown corporation, CN is also active in a number of other businesses. CN Real Estate manages the development of the corporation's urban property assets, while other company units include CN Exploration, engaged in petroleum resource development in Western Canada; the CN Tower in Toronto; and Canac International, an international transportation and telecommunications consulting service. The Grand Trunk Corporation, a CN subsidiary, markets rail freight services in the northeast and midwest United States.

TABLE OF CONTENTS

1	SYSTEM HIGHLIGHTS
2	CHAIRMAN'S MESSAGE
2	PRESIDENT'S REPORT
6	KEEPING CANADIAN INDUSTRY ON TRACK
10	THE BEST OF BOTH WORLDS
12	STRAIGHTENING THE LINE
14	BUILDING THE HIGH-TECH RAILWAY
16	COMMITTED TO SAFETY AND THE ENVIRONMENT
18	PEOPLE POWER FOR TOMORROW'S NEEDS
20	RESHAPING THE CORPORATION
22	GROWING IN THE GLOBAL MARKETPLACE
25	FINANCIAL REVIEW
27	MANAGEMENT REPORT
27	AUDITORS' REPORT
28	CONSOLIDATED FINANCIAL STATEMENTS – CN SYSTEM
40	CANADIAN NATIONAL PENSION TRUST FUND
46	DIRECTORS
47	OFFICERS AND LIST OF COMPANIES

Five Year Financial and Statistical Summary

($ millions unless otherwise indicated)	1989	1988	1987	1986	1985
Operations					
Revenues	$ 4,203.5	$ 4,674.7	$ 4,785.6	$ 4,874.5	$ 5,017.8
Operating income	$ 396.3	$ 546.4	$ 487.4	$ 279.4	$ 440.0
Interest expense – net	$ 199.2	$ 300.5	$ 371.9	$ 382.3	$ 336.2
Net income (loss)	$ 205.8	$ 282.7	$ 120.6	$ (86.3)	$ 117.6
Dividend	$ 41.2	$ 56.5	$ 24.1[1]	$ —	$ 23.5[1]
Return on average investment %	8.4	10.3	7.9	4.6	7.2
Return on average equity %	6.0	8.7	4.0	—	3.5
Capital Expenditures					
Property and equipment	$ 371.0	$ 386.3	$ 482.1	$ 484.1	$ 744.5
Assets and Working Capital					
Current assets	$ 1,082.5	$ 945.7	$ 965.8	$ 1,124.6	$ 1,128.0
Working capital deficiency	$ 139.0	$ 194.0	$ 485.4	$ 373.6	$ 358.6
Properties	$ 5,814.1	$ 5,770.4	$ 6,212.5	$ 6,248.5	$ 6,193.5
Total assets	$ 7,105.4	$ 6,906.0	$ 7,593.6	$ 7,842.6	$ 8,138.8
Capital Structure					
Long-term debt (including current portion)	$ 1,929.9	$ 2,014.9	$ 2,936.9	$ 3,358.3	$ 3,172.2
Equity	$ 3,539.4	$ 3,374.9	$ 3,101.1	$ 3,004.6	$ 3,418.5
Debt ratio %	35.3	37.4	48.6	52.8	48.1
Traffic					
Revenue ton miles freight (billions)	96.3	104.5	101.7	94.2	91.6
Employees					
Average number for year	40,934	43,933[2]	50,862	56,715	61,124
Average annual wage per employee (dollars)	$ 41,241	$ 39,042[2]	$ 36,706	$ 35,680	$ 34,484
Average annual cost per employee (dollars)	$ 52,021	$ 48,940[2]	$ 46,218	$ 43,897	$ 41,016
Expenditures in Canada					
Purchases	$ 875.8	$ 908.7	$ 895.0	$ 1,034.0	$ 1,232.0
Wages, salaries and fringe benefits	$ 1,866.2	$ 1,872.6[2]	$ 1,969.8	$ 2,064.1	$ 2,070.0
Taxes	$ 360.1	$ 348.1	$ 351.7	$ 367.3	$ 347.0

[1] *Reversed in 1988*
[2] *Excluding business units sold during 1988*

The Honourable Douglas G. Lewis
Minister of Transport

Dear Mr. Minister:

On behalf of the Board of Directors and in accordance with provisions of the Railway Act, I am pleased to submit Canadian National's annual report for the year ending December 31, 1989.

Free trade with the United States and an increasingly competitive international marketplace pose enormous challenges for Canada's industries. To meet the challenges successfully, our industries must confront issues of productivity and competitiveness. CN is determined to provide transportation and distribution services of the quality and value its customers need to compete effectively.

Based in Vancouver, I intend to focus particular attention on supporting a stronger role for CN in serving the needs of western Canadian producers as they seek expanded markets throughout the Pacific Rim.

During the months since my appointment, I have had the privilege of meeting and working with many of CN's people as they plan and execute the company's response to business and financial challenges. I am confident in their ability to lead the corporation into the 1990s, and commend all the company's officers and employees for continuing to improve CN's ability to help Canadian shippers grow in the global marketplace.

Brian R.D. Smith, Q.C.
Chairman

March 30, 1990

PRESIDENT'S REPORT

Ronald E. Lawless
President and Chief
Executive Officer

Canada faces a critical decade as the nation enters the 1990s. Its industries are challenged to excel in a competitive environment that has become global in scope and unprecedented in intensity.

As an important part of the transportation network upon which Canadian industry depends, Canadian National sees its role as that of a willing, capable partner of shippers in their pursuit of success in the global marketplace.

That role, performed effectively, requires that CN achieve two objectives. It must offer quality service to shippers – reliable, competitively priced freight transportation and distribution designed to meet each customer's particular needs.

Second, it must be financially healthy, able to make the investments in plant and services that its commitments to customers require. On behalf of its shareholder, CN must effectively manage and enhance the value of the assets that make up the corporation.

1989 results reflect slowdown

Income and traffic volumes in 1989 did not set records, but progress was made towards the goals of quality service and financial self-sufficiency.

Net income for 1989 totalled $205.8 million, down from the record $282.7 million reached the previous year. Income before tax was $256.8 million, of which railway operations in Canada contributed $125.0 million. U.S.-based Grand Trunk Corporation and non-rail activities (CN Real Estate, CN Exploration, CN Tower, and Canac International) provided the remainder.

The decline in net income was due mainly to slowdowns affecting a number of key resource sectors, notably the grain, sulphur, potash, and lumber industries. Overall, freight revenues dropped by about seven per cent, from $3.5 billion in 1988 to $3.3 billion.

CN responded by slowing scheduled expenditures and exercising strict cost control. This action contributed to net income higher than might have been expected under the circumstances.

Since the economy is continuing to cool, CN is not likely to show better traffic or financial results over the next few years.

The company succeeded in further reducing indebtedness during 1989, mainly by strict cost controls throughout the organization. Now at $1.8 billion, indebtedness is down significantly from $1.98 billion at the end of 1988 and slightly more than half the high of $3.5 billion recorded in 1986. As a result, annual interest payments were some $180 million lower than the level of three years earlier.

Regulatory issues

In 1989, the National Transportation Agency conducted its first annual review of the impact of the National Transportation Act, 1987.

The agency noted that although it was too early to assess the full impact of the legislation with any precision, experience during 1988 appeared promising. The railways had stepped up structural reform in response to greater competition in the marketplace, while shippers surveyed by the agency expressed general satisfaction with the level of service provided.

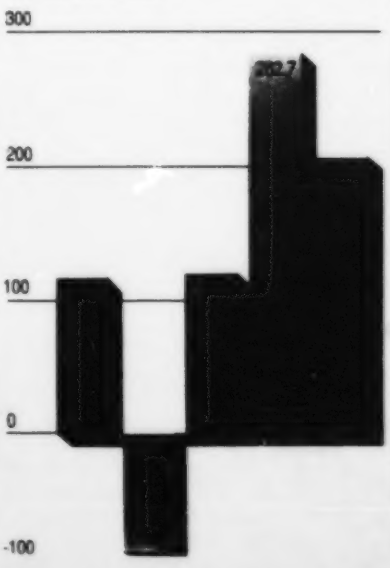
CN agrees that NTA '87 has benefited Canadian shippers and, to some extent, Canada's railways. However, concern remains about the potential long-term effects on railway viability of some of the Act's provisions, especially those related to competitive access.

Revenue growth over the next few years is expected to lag behind the inflation rate, reflecting, in part, pressure on freight rates from regulatory reform. Even though expenses are rising in line with increases in the cost of living, CN is determined to maintain service levels in spite of reduced profit margins.

Competitive balance between modes and carriers is particularly important as free trade with the United States comes into effect, as competition for transportation markets intensifies, and as market competition faced by Canadian shippers increases.

CN Net Income

in millions of dollars



Heading for markets: CN trains take shape at Thornton yard in Vancouver.

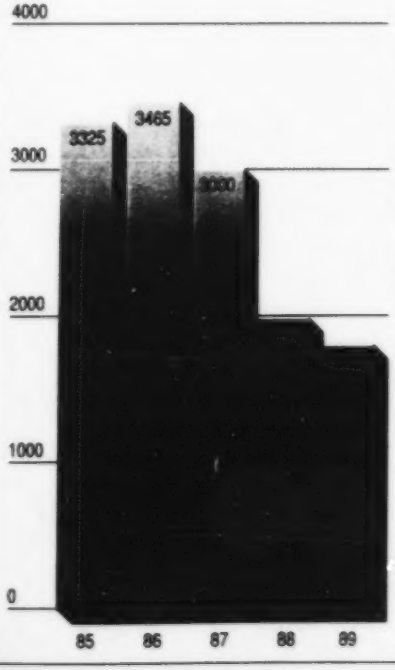
CN expects free trade to stimulate Canadian industrial activity and therefore generate business opportunities for the railway. However, since traffic flow increases will tend to be north-south, Canada's railways will have to improve efficiency and productivity to capture a larger share of traffic from less-regulated trucking and U.S. railways.

In 1989, the federal government released a policy paper on agriculture that proposed review of the Western Grain Transportation Act (WGTA). Since coming into effect in 1984, the WGTA has stimulated improvement to the efficiency of the western grain transportation system.

However, CN believes that certain changes in WGTA regulations could further strengthen the competitiveness of the grain industry. Greater flexibility to adjust costs to market demand, and incentives to improve productivity, would help the railways become more responsive to grain producers' needs.

In this regard, CN is seeking leave to appeal a National Transportation Agency decision in 1989 relating to railway costing that in effect denies railways the ability to benefit from productivity gains in grain transportation.

CN Indebtedness
in millions of dollars



Financing the future

It has been estimated that CN needs significantly higher pre-tax income annually to finance capital requirements for plant renewal and service expansion.

Substantial reduction in indebtedness over the past three years has strengthened the company's balance sheet. Yet CN still falls short of the returns on investment being attained by its main North American railway competitors. Achieving returns that are consistently in a range higher than at present is needed to secure CN's full financial self-sufficiency over the long term.

What will it take to reach that goal? Management believes change is needed in four areas important to the company's well-being:

- Closer, more creative relationships with customers are essential, with CN designing and delivering the better quality, innovative service packages that freight shippers need and can often get from other carriers.

Focusing on the customer is an ongoing process at CN. The comments of customers in the pages of this report bear witness to these efforts. However, much more can – and will – be done.

- New understandings must be reached with the labor unions that represent CN's employees, and with unionized employees themselves, based on a common interest in creating a viable and competitive company.

With respect for each other's goals, as well as willingness to accommodate each other's particular needs, management and labor may be able to work out solutions to some of the problems that keep CN from being as productive and competitive as the marketplace demands.

- Needed is a fresh look at transportation policy in Canada and acknowledgement by policy-makers, at all levels of government, that the viability of carriers is essential to their providing the level and cost of service Canadian industry must have to compete internationally.

Ideally, this assessment should examine the issue of modal competition. It should undertake to determine whether current highway funding and cost recovery regimes, as well as fuel tax policies, discriminate against railways to the benefit of the trucking industry, and to what extent any imbalance affects shippers' options as well as costs borne by consumers and taxpayers.

- Finally, a realistic impression of CN and its role, on the part of all Canadians, is essential. Railways are sometimes seen as moribund relics of a simpler era, rather than as vital partners of Canadian industry in helping to keep our economy prosperous.

These attitudes, all too often, stand in the way of the progress CN must make to enhance the value of its services to customers in the future.

CN people lead the way

Over the past decade, the shape and size of Canadian National has undergone a radical transformation. It now draws on its intermodal strengths rather than on rail alone to serve some parts of the country. It employs little more than half as many people as it did 10 years ago, and it has divested businesses in which it had an important presence for many years – marine, hotel, trucking, and public telecommunications services.

The process of redefining and refining Canadian National is continuous, as long as markets evolve and trade patterns shift. To keep pace with competition, CN cannot hold to the status quo but must constantly improve services, performance and productivity. The goal is to match services and activities with the needs of customers and with those of Canadian society.

CN's future depends to a very great extent on the skills, talents, and attitudes of all CN employees.

During difficult times in the past decade, they have been, in large part, understanding and willing to do their share in spite of uncertainties. They are largely responsible for the many successes the company has enjoyed. I know they can be counted on to come through again as CN people have done so often in the past.

R E Lawless

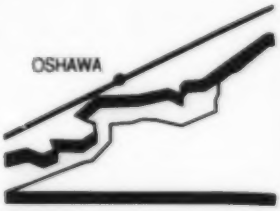
Ronald E. Lawless

Wet pavement mirrors CN coal hopper cars at Roberts Bank terminal near Vancouver.

From left to right: J.H.D. Sturgess, Senior Vice-President and Chief Operating Officer; Y.H. Masse, Senior Vice-President and Chief Financial Officer; W.H. Morin, Group Vice-President.

KEEPING CANADIAN INDUSTRY ON TRACK

Canada's industries need reliable, affordable transportation services to help keep their products competitive.

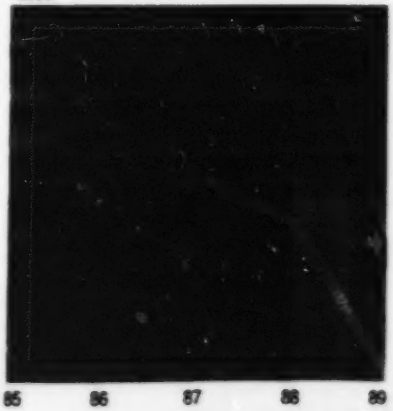


CN is well aware that its own success depends largely on how effectively it meets industry's needs. During 1989, the company concentrated on expanding the range and improving the quality of its services to freight shippers.

CN's customers, across Canada, receive from and ship to markets close to home, in the United States, and throughout the world. This multiplicity of origins and destinations is reflected in the railway's traffic, roughly evenly divided among domestic carryings, transborder traffic, and import/export goods.

To serve such a broad range of needs, CN adopts a total distribution concept. That means looking at its business as an integrated, intricate series of transactions from production site to end-user.

Rail Revenues Compared to Rail Expenses
in millions of dollars



Total distribution is exemplified in the way CN provides just-in-time delivery of auto parts to automobile assembly plants and then distributes finished automobiles across Canada and to the United States. In some cases, CN's role extends all the way to dealers, through such facilities as the company's Autoport in Halifax and auto compounds in major centres.

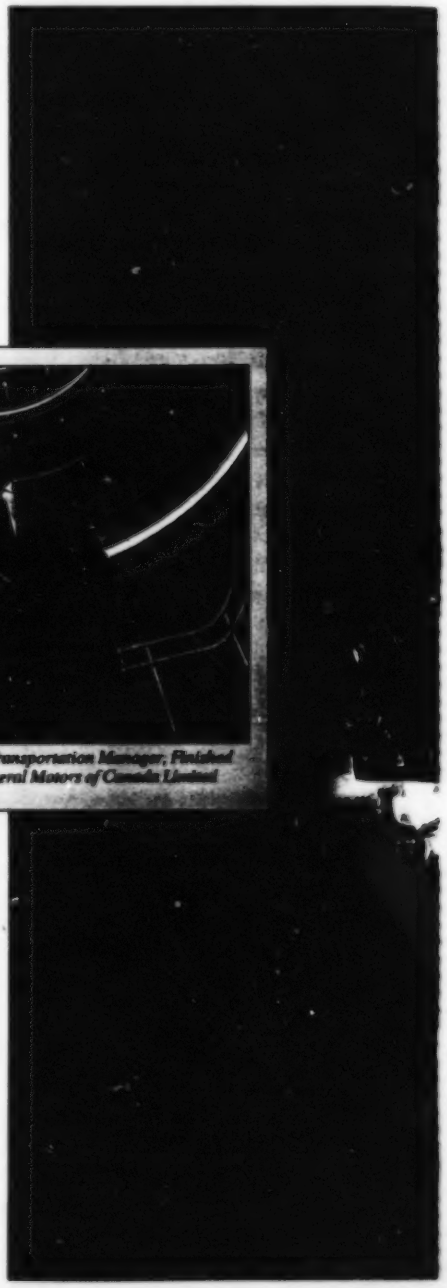
"GM expects high-quality performance from its carriers. We won't accept anything less from CN than reliable, economical, damage-free delivery of our vehicles."

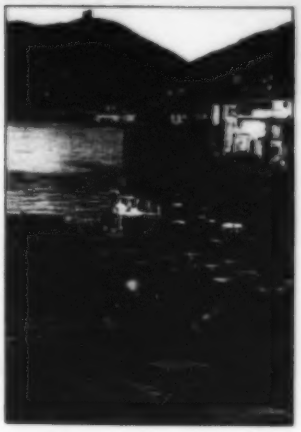
Jim Lashey, Transportation Manager, Finished Vehicles, General Motors of Canada Limited

Automakers insist on total quality in their own operations, and they demand the same of the carriers they use. CN retains their business by supplying comprehensive price and service packages that satisfy the customer's need for reliability and value.

Adding value to distribution products

CN looks to alliances and joint arrangements with other railways, other modes, and operators of ancillary services to design the right dis-





Vehicles produced at General Motors' new plant in Oshawa, Ontario, (below) arrive in showroom condition at dealers across Canada. Using a coordinated rail and ship service (left), CN helps provide timely distribution of GM vehicles to Newfoundland.

KEEPING CANADIAN INDUSTRY ON TRACK
(CONTINUED)

New video system for rail car identification produces faster, more accurate information on freight shipments. CN's Roy Boudreau (left) reviews system features with a supplier representative.

Quality service – speed and reliability – is the target for CN's freight trains linking east and west. Here, a fast freight pierces the Rockies.

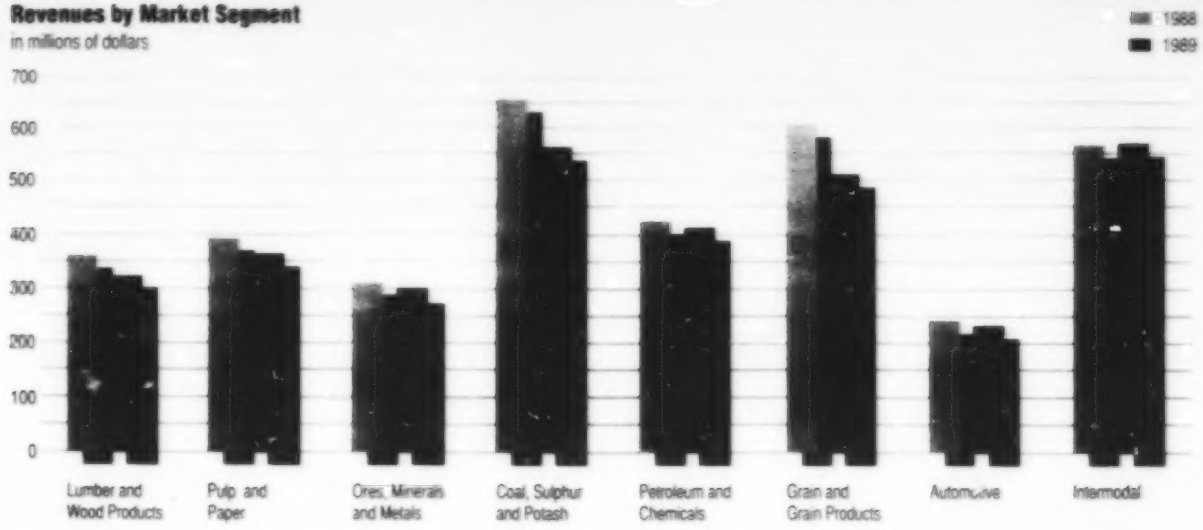
Shippers today want value from their distribution dollars. They know their business and the transportation market intimately. They understand the close relationship between distribution and other elements in their business and how transportation, in the final analysis, can affect their customers' satisfaction.

The more open market brought about by regulatory reform is in part responsible for the sharper eye with which shippers now gauge distribution costs. Even more significant is the impact of global competition on many Canadian industries and the need to hold the line on all business costs.

CN's eight commodity-based marketing business units work in partnership with shippers, responding to their needs and to new opportunities more quickly and appropriately.

A new on-line Customer Service System has been developed to track customers' service requirements, while a companion program, the Customer Monitoring System, will assess actual performance against customer specifications.

CN is developing a Customer Service Plan process to help define customers' needs and ensure they receive the service they require. The plans cover every aspect of CN's total service packages, going beyond the sales force to involve other railway and customer personnel with a role to play in service design and delivery.



The railway is now using an extensive telemarketing network to expand customer contact and generate new business. Teamed with computer information systems, telemarketing is proving effective in reaching out to customers beyond rail's traditional scope.

Quality at Work

The quality of CN's services, and the satisfaction of its customers, depend on the skills, ideas, motivation and efforts of the people who deliver the product – railway employees.

CN's "Quality at Work" (QAW) process is designed to help overcome barriers and promote customer awareness throughout the company.

The process was stepped up and expanded in 1989. It focuses on the competitive environment, markets and customers, providing opportunities for initiative, individual judgment, and recognition of achievement.

Within the next few years, a good many employees will have had an opportunity, through QAW, to identify with the customer and learn the significance of their jobs in relation to customer satisfaction.

The continental connection

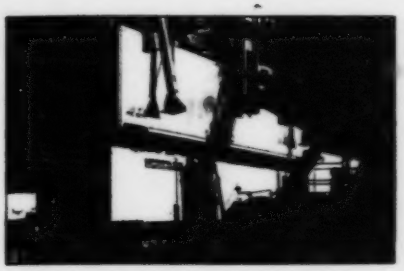
CN's rail services reach into U.S. markets through the Grand Trunk Corporation, the company's wholly owned Detroit-based subsidiary. GTC's three units (Grand Trunk Western Railroad; Duluth, Winnipeg and Pacific Railway; and Central Vermont Railway) together penetrate much of the northeastern and midwest United States and gain access to a number of major U.S. lines through connections at Cincinnati, Chicago and Duluth.

In response to intense competition in the U.S. railway industry, all three units have been pursuing aggressive marketing and cost control strategies. These efforts have paid off in financial performance. In 1989, the corporation paid a US $10.5 million dividend to CN.

As commerce between Canada and the United States grows under free trade, GTC is becoming increasingly important to CN in expanding its share of trans-border movements.

CN's Leadership Centre for senior managers focuses on the challenges facing CN in meeting shippers' needs. Customers and distribution partners play an important role in the process, bringing their own perspective to the table. Above, Richard Gaetz, president of pool car operator Trans Western Express, discusses customer service issues with a CN management group.

THE BEST OF BOTH WORLDS



Intermodal service, combining the efficiencies of long-haul rail with the flexibility of trucking, is an important wave of the future in Canadian transportation.

In 1989, CN's intermodal operations continued to show greater revenue growth than overall freight business. Its importance will increase as the rail network is further rationalized and the company reaches out to customers formerly served exclusively by rail, as well as to new customers that have never used rail-based services in the past.

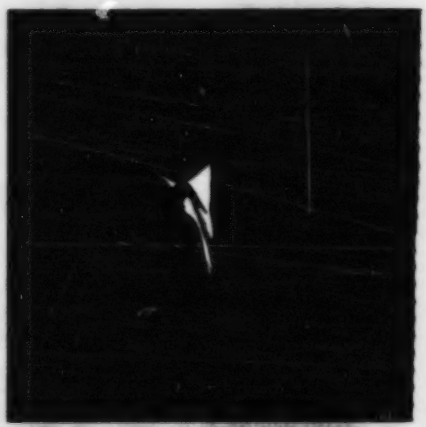
Intermodal competes head-on with highway trucking for a market in which service quality, speed, and reliability are the key factors.

A new $19-million intermodal terminal near Vancouver is under construction, completing a plan to upgrade CN's six major hub terminals across Canada. By expanding its intermodal capability on the West Coast, CN is working to capture a larger share of growing Pacific Rim container trade.

Orders were placed for new equipment that will enhance intermodal's versatility and permit CN to initiate more competitive train service. CN's Transcona shops at Winnipeg manufactured 40 new-generation five-platform rail car sets capable of accommodating double-stacked containers and the largest highway trailers. Trenton Works Lavalin in Trenton, Nova Scotia, produced 60 articulated rail car sets with similar carrying ability.

CN anticipates moving into double-stack container trains for domestic traffic as one means of combatting highway competition. Through agreement with Maersk Line and Sealand, CN handles the Canadian portion (between Buffalo, N.Y., and Toronto/Montreal) of double-stack overseas container trains originating at Tacoma, Washington.

CN is well positioned to move quickly into this promising field.



Nick Mauro, Director of Logistics, Customer Service, Kraft General Foods Canada Inc.

Road to rail: Giant crane loads a semi-trailer on a rail car at CN's intermodal terminal in Brampton, Ontario.

Overseas containers come ashore at the Port of Halifax.

Containers from Pacific Rim vessels ready for transfer to rail at Vancouver.

Below: Grocery products are assembled for intermodal distribution to supermarkets from Kraft's processing plant in Montreal.

"In our business, we need flexible, reliable distribution to get our products onto grocery shelves at precisely the right time. That's what we demand of CN's intermodal and carload services."

STRAIGHTENING THE LINE

The shape and size of CN's rail network still largely reflects the form and needs of Canada as they were a hundred years ago, when railway expansion was the engine driving the forces of nation-building.

Below, carloads of Western Canadian coal feed an Ontario Hydro electrical generating plant.

Portions of the network recall a time when railways were virtually unchallenged by any competing modes in the movement of goods and people across a vast, sparsely populated land.

For CN, the legacy of the past, and the ultimate impact of publicly supported competition, is that today, one third of the network carries just one per cent of the railway's traffic. CN has the lowest traffic density of any major North American railway, a fact that contributes in no small measure to its significantly higher cost base.

CN believes it can best serve the needs of Canadian industry, and remain financially sound, by developing a strong, well-utilized core railway network, reaching out to customers through intermodal services and through feeder lines operated as short-line or regional railways.

The company has identified its least productive lines and is looking into a number of options, including line sales or transfers, joint track use, and outright abandonment.

Negotiations were undertaken, and concluded successfully in January 1990, for the transfer of a 240-km rail line between Cochrane and Calstock to the Ontario Northland Railway. CN also arranged for the sale and lease of portions of the route between Massena, N.Y., and Montreal to the Consolidated Rail Corporation.

"Hydro customers demand low-cost, dependable electric power. We look to rail carriers like CN for flexible, cost-efficient delivery of coal to our thermal plants."

Doug Smith, Director of Fuels Ontario Hydro

In many cases, short-line railway operation can preserve service on marginally economic lines that cannot be operated profitably by large carriers. One such venture, finalized early in the year, was the sale of CN's Grand Trunk Eastern line in New England to Emons Development Corporation.

When trucking all but eliminated demand for rail service in Prince Edward Island, CN developed an efficient intermodal alternative that recaptured some 55 per cent of the province's potato traffic. In 1989, the company was given permission to discontinue rail operations in the province, ending losses of about $2 million annually.

Thermal coal from Western Canada heads through the Rockies to industrial markets.

Coal is transferred from rail to ship at Neptune Terminal, Vancouver.

BUILDING THE HIGH-TECH RAILWAY

Advances in technology over the past few decades have contributed to a tremendous increase in CN's efficiency and safety. With new computer and communication technology, CN people are able to respond quickly to customers' requirements.

During 1989, CN invested more than $80 million in technology with potential to improve productivity and competitiveness.

A major program to mechanize track maintenance was implemented, in consultation with unions representing track workers. The program, involving expenditure of $40 million on heavy equipment, will speed up and reduce the costs of maintenance work while adding to safety.

CN also launched its third, most advanced track inspection car (TEST III) which uses electronic technology to record track conditions and identify any defects that could cause accidents.

The railway is among the leaders in an industry-wide high-technology project known as Advanced Train Control Systems (ATCS).

Early in 1989, CN announced plans to implement a $14-million ATCS pilot project on its line between Prince George and Prince Rupert, B.C. ATCS uses sophisticated computer technology to monitor and control train movements, safely and efficiently.

The company has engaged AMCI Inc. to supply a Work Order Reporting System (WORS), allowing train crews to communicate train and car movements by means of a computer in the locomotive cab. WORS will permit CN to give customers prompt information on the status of their shipments and to relay new instructions to train crews in a timely manner.

In March 1989, the Federal Court of Appeal set aside parts of a labor arbitrator's ruling that attached certain conditions to the operation of cabooseless trains. The decision set the stage for agreement between CN and the United Transportation Union on replacing cabooses with end-of-train electronic monitoring units. CN's first cabooseless trains began operating early in 1990. When fully implemented, cabooseless operations will save the railway millions of dollars annually in operating costs.

Computer in locomotive cab helps train crew speed shipments, using work order reporting system.

CN spent more than $100 million in 1989 on acquisition of new and modified rolling stock to increase efficiency and better accommodate customers' needs.

The railway took delivery of 60 technologically advanced locomotives purchased from General Motors of Canada Limited, London, Ontario, at a cost of $120 million. Delivery of another 30 new locomotives, manufactured by General Electric Company and costing $60 million, is expected during the first half of 1990. The company also placed a $35-million order with National Steel Car Company of Hamilton, Ontario, for 500 rail cars to carry woodpulp traffic.

Walter Osti, Vice President, Logistics Kimberly-Clark Canada Inc.

Opposite: An inside look at Kimberly-Clark's plant at St-Hyacinthe, Quebec, which produces diapers and other consumer products.

"Kimberly-Clark's quality management process goes all the way from factory to consumer. By getting more involved in our business, CII can respond better to our distribution needs."

COMMITTED TO SAFETY AND THE ENVIRONMENT

Safe railway operations and environmental awareness are more than pious sentiments at CN. They are key factors in providing quality service to customers and a good indication of how seriously the railway views its responsibility to employees and the public.

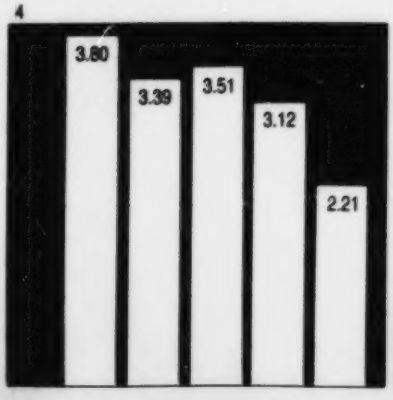
The railway's safety record has regularly ranked among the best in North America, showing steady improvement over the years. In 1989, CN was second among major North American railways in terms of employee disabling injuries, and third in train accidents per million locomotive miles.

This performance came about through continuing efforts to apply safety-enhancing technology and safety awareness throughout the railway.

Safe operations depend significantly on the competence, physical fitness and attitudes of railway employees. CN's training programs for employees involved in running and maintaining trains place special emphasis on safe operating procedures.

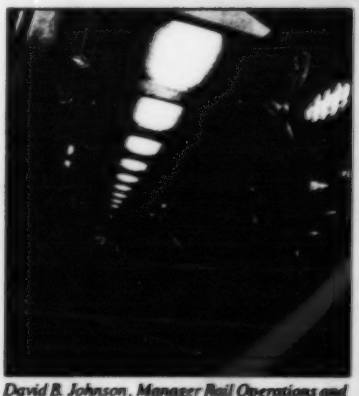
CN participates actively in Transportation Community Awareness and Emergency Response (TRANSCAER), a communications initiative of the Canadian Chemical Producers' Association to promote safe handling of hazardous goods.

Accidents per million locomotive miles



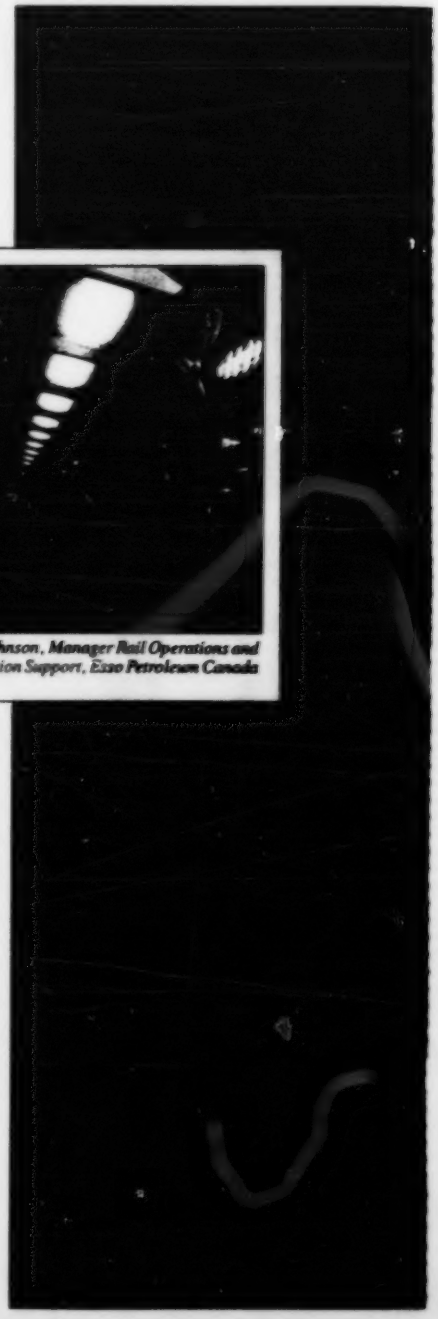
CN shares with all Canadians their concern about protection of the environment. The company is committed to ensuring it does not contribute to pollution of air, water and land, and does not interfere with the quality of life in the communities it serves.

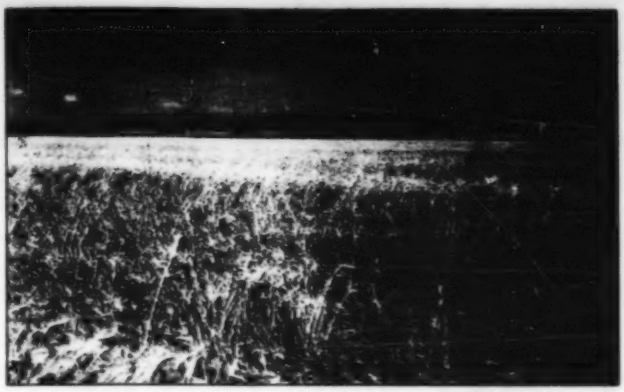
"Close partnership with carriers is vital to supplying the Far North. CN people have to do what they promise to do, when they promise to do it – and maintain high standards of safety and environmental protection."



David B. Johnson, Manager Rail Operations and Transportation Support, Esso Petroleum Canada

The company established an internal task force on the environment in 1989 in response to the public's growing ecological concerns. The task force is reviewing CN's policies and practices, and will report in 1990 on appropriate actions the company should undertake.





Tank cars carrying petroleum products cross the Prairies.

Below: Esso's refinery at Edmonton supplies vital petroleum products to communities as far north as Hay River, on Great Slave Lake.

PEOPLE POWER FOR TOMORROW'S NEEDS

In the final analysis, it is people – CN's human resources – that represent the company's ability to put all its other resources to best use. The quality of their efforts is the vital ingredient in the delivery of quality service.

Below: Noranda Minerals subsidiary Brunswick Mining and Smelting extracts zinc, copper and lead concentrates at Bathurst, New Brunswick.

CN is committed to encouraging and rewarding skill, innovation and customer-consciousness in its workforce. In 1989, the company stepped up its drive to provide employees with the tools they need to contribute to the best of their ability to the goal of quality service.

A comprehensive evaluation of internal training programs was completed during the year. The study will culminate in intensified skills development and management education to derive greater value from the $45 million CN spends annually on training employees.

CN inaugurated a Leadership Centre for senior officers in 1989 to focus the thinking of decision-makers on strategic direction for the company in the years ahead. A complementary program, "Managing our Business", focuses on the business issues facing CN and the goals and strategies the company has adopted to manage them.

CN has an obligation and a commitment to ensure that its workforce reflects the diversity of Canadian society. Management knows as well that it can increase the quality of its services by recruiting and promoting people from a broader pool of candidates. During 1989, the company increased the representation of women, members of visible minorities, native people, and people with disabilities, despite workforce reductions and lower hiring levels.

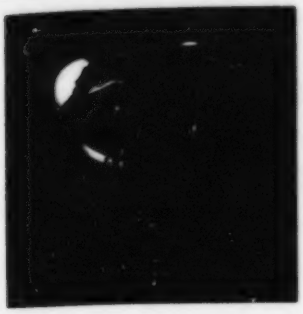
Employment equity initiatives include working with outside organizations to improve access to jobs at CN, scholarship programs for women and native people, and an active communications effort to involve all employees in achieving equity goals.

CN and representatives of all its union groups successfully negotiated new three-year labor contracts during 1989. In addition to wage increases totalling 13.6 per cent over three years, the agreements provide guaranteed pension increases, indexed to the cost of living and tied to gains from investments made by the CN Pension Fund.

It is hoped that the new agreements, and the spirit of cooperation that generally marked the negotiations, will set the stage for a new understanding between management and labor on meeting CN's competitive challenges.

"CN has been our transportation partner ever since we started mining at Bathurst 25 years ago. Teamwork between our people and CN's people is vital to efficient distribution of our products."

William G. Deeks, President Noranda Sales Corporation Ltd.



CN people hold the key to the future. Pictured here from left: Clive Welch, Lorie Dwornick, Mary Kaye, Frank Stewart.

RESHAPING THE CORPORATION

During the past four years, CN divested a number of businesses in which it had an important presence dating back to the company's formation – public telecommunications services, hotels, trucking, and marine services.

Lumber from British Columbia's forests on its way to meet construction needs across the continent.

Divestiture of these businesses has strengthened the corporation's financial base and allowed CN to concentrate its energies and resources on its core businesses. Rail-based transportation and distribution remains the corporation's fundamental activity, while participation in real estate development will be an important factor in CN's future success.

The company has reshaped its rail organization more in line with marketplace demands. On the operations side, CN completed a restructuring of transportation, engineering, and equipment functions in 1989. The new district form of organization allows the railway to respond more rapidly and effectively to customer needs.

The corporation's non-rail business activities maintained strong performance in 1989. These units provide steady income to the corporation and help offset any decline in rail revenues during economic downturns.

CN Real Estate is responsible for the planning, commercial development and management of the company's real estate assets. With a growing land portfolio that includes prime properties in major urban centres across Canada, the unit will continue to play a significant role in Canada's real estate market throughout the new decade.

During 1989, CN Real Estate completed the infrastructure surrounding Toronto's SkyDome, including a retail walkway linking the stadium with Union Station. Ground-breaking for the first component of CityPlace, Canada's largest redevelopment project, is expected late in 1990. CityPlace will provide prime office space and new housing units west of SkyDome.

The new TD Centre in the heart of Winnipeg will be completed in 1990, while in Edmonton, CN Real Estate is involved in redeveloping the former site of CN's downtown rail yards. The site will house commercial and residential properties as well as a new community college.

CN Exploration manages the development of CN's petroleum assets in Western Canada. A total of 1.29 million barrels of oil was produced during the year, down slightly from the previous year, while reserves, as of year-end, rose from the 1988 level of 8.1 million barrels (or equivalent) to 9.2 million.

CN Tower continues to be a major tourist attraction in Toronto, welcoming 1.7 million visitors during 1989. Development of CityPlace, and the Tower's proximity to the SkyDome and the Metropolitan Toronto Convention Centre, should lead to increased business and income in the years ahead.

John Darker, Vice President Transportation and Purchasing, Weldwood of Canada Limited

CN's consulting activities had another successful year in 1989. Canac International, in conjunction with CN Communications, is active on transportation and telecommunications projects in more than 30 countries.

Opposite: Weldwood sawmill at Squamish, British Columbia, produces wood products

“Weirwood faces tough competition in all its markets. We want the railways we use to understand the challenges out there and join us in our marketing efforts. A solid partnership with CN will help us find that competitive edge.”

GROWING IN THE GLOBAL MARKETPLACE

Decisions made today will shape the quality of the Canadian economy and society in a new century and a new millenium.

Canadian grain moves from rail car to ship's hold en route to overseas markets.

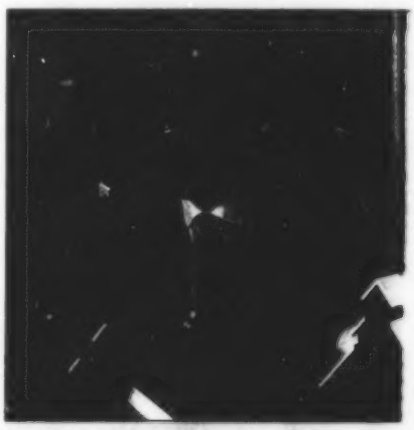
Canadian National's planners and decision-makers are very much aware that they must look beyond the short term and fix their sights on the all-important goals of financial self-sufficiency, as reflected in a commercial rate of return, and quality service to Canadian shippers.

To cope with competitive pressures that can only intensify, and prepare itself for a continuing vital role in Canada's progress, CN has adopted these objectives to guide its direction in the years ahead:

- It will enhance the quality of its services to customers, adding value to earn a competitive edge. Special attention will be focused on expanding intermodal services and on seeking new business opportunities.
- The company will concentrate on increasing productivity through better utilization of all its resources and strategic use of new technology.
- The railway will continue tailoring the size and shape of the rail network to marketplace demands.
- It will invest in developing the skills of its employees, and promote innovation in the delivery of quality service through recognition and reward.
- CN will work with union leaders to adopt mutually acceptable ways of enhancing railway productivity and competitiveness.
- It will maximize the contribution of non-transportation assets to help secure CN's financial future.
- Management will, to the best of its ability, continue to administer the company's assets effectively on behalf of the shareholder.
- All decisions and activities will reflect the company's responsibility to safety, environmental protection, and the best interests of employees, communities, and the Canadian public.

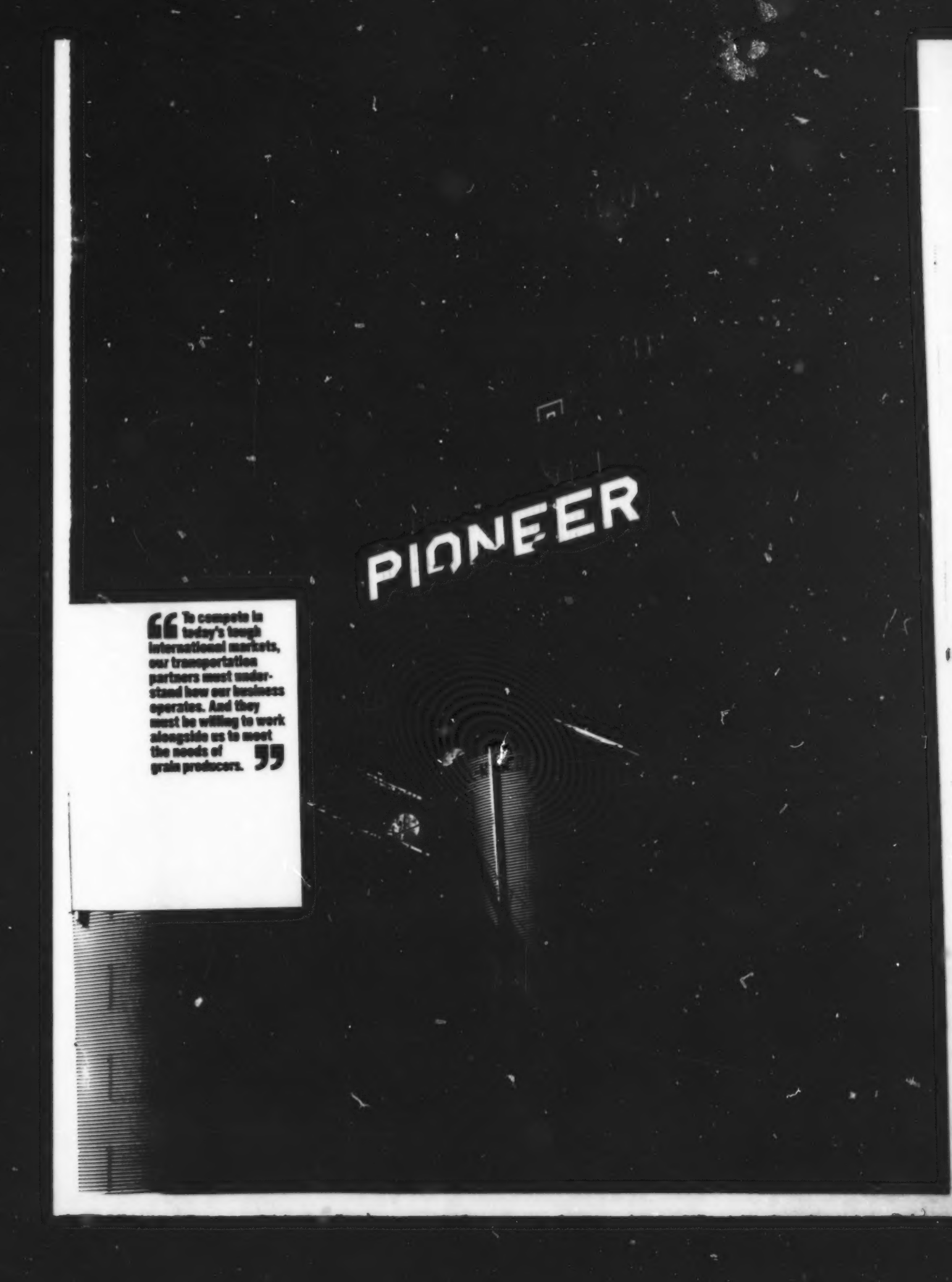
CN is looking to Canadian governments, at all levels, to recognize the importance to Canada of having commercially viable carriers. The company hopes such recognition will lead to implementation of policies that will create an equitable, competitive transportation marketplace.

Within that climate, CN can best help Canadian industry grow in the global marketplace.



Jean Mulaire, Manager Transportation Policy and Land Management, Pioneer Grain Company Ltd.

Opposite: Grain elevator at Kamsack, Saskatchewan


PIONEER
"To compete in today's tough international markets, our transportation partners must understand how our business operates. And they must be willing to work alongside us to meet the needs of grain producers."

FINANCIAL REVIEW AND CONSOLIDATED FINANCIAL STATEMENTS

INDEX

25	FINANCIAL REVIEW
27	MANAGEMENT REPORT
27	AUDITORS' REPORT
28	CONSOLIDATED STATEMENT OF INCOME
29	CONSOLIDATED BALANCE SHEET
29	CONSOLIDATED STATEMENT OF RETAINED EARNINGS
30	CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
31	NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

RESULTS OF OPERATIONS

System net income for 1989 totalled $205.8 million compared with $282.7 million in 1988 and $120.6 million in 1987. Income from continuing operations was down $37.3 million from 1988, but was up $65.8 million from the 1987 level. The 1989 decline in income from continuing operations was due mainly to lower income from Canadian rail operations offset to some extent by improved results from the Enterprises Group and a decline in interest expense of $101.3 million from 1988 resulting from the Company's debt reduction program. The principal factor in the Enterprises increase was higher land sales by CN Real Estate. Factors affecting net income in 1988 for which there is no comparable item in 1989 include: (a) losses from discontinued operations, which in 1988 totalled $26.1 million; (b) a $111.1 million premium on the early extinguishment of long-term debt; (c) gains of $170.2 million on the disposal of certain business units; (d) closure costs of $51.0 million on discontinued operations; (e) a write-down of assets of $34.6 million. Items c, d, and e are net of income taxes and are accounted for as extraordinary items. In 1989, losses carried forward from prior years only partly reduced income taxes. As a result, net income taxes charged against earnings amounted to $51.0 million in 1989 compared with $4.3 million in 1988 and $1.1 million in 1987.

The 1988 improvement was generated principally by CN Rail which experienced record traffic volumes and continued expense reductions. Higher income from the Enterprises Group, reduced losses from discontinued operations and the net effect of the extraordinary and unusual items mentioned above also contributed to the 1988 income betterment over 1987.

The results for each division, which are discussed below, include the assignment of interest expense. This expense aggregated $199.2 million for the System in 1989, $300.5 million in 1988 and $371.9 million in 1987. In both years the decreases were caused mainly by debt reduction and the strengthening of the Canadian dollar against the U.S. dollar.

CN RAIL

CN Rail's income amounted to $125.0 million in 1989 compared with $220.7 million in 1988 and $113.7 million in 1987. Lower freight revenue was mainly responsible for the 1989 reduction, while increased freight revenue and reduced expenses were the principal factors in the 1988 improvement.

Railway operating revenues totalled $3,528.3 million in 1989, down $263.8 million from 1988 and $204.0 million from 1987. Freight revenues were down $257.6 million from 1988. The main factor contributing to this decrease was lower traffic volumes. Except for intermodal and ores, minerals and metals, all commodity groups registered revenue declines. The most significant decreases occurred in grain, sulphur and potash traffic. Non-freight revenues were down from 1988 levels. Revenues from the contract with VIA Rail Canada Inc. (VIA) declined by $8.7 million due to lower workloads. Because of cutbacks in VIA services that occurred in January, 1990, future revenues from this source will be substantially reduced. Subsidy revenues and receipts from U.S. currency exchange on interline freight also decreased.

Freight revenues in 1988 were $78.4 million higher than in 1987 mainly because of record 1988 traffic levels. The greatest increases occurred in the coal, sulphur, potash; pulp and paper; automotive; and petroleum and chemicals commodity groups. Passenger contract revenues declined by $53.9 million because of the transfer to VIA of responsibility for certain activities and lower workloads. However, increases in receipts from U.S. currency exchange on interline freight and from other revenues helped to moderate the effect of the passenger revenue reductions.

Expenses in 1989 were $3,403.3 million, down $168.1 million from 1988 and $215.2 million from 1987. Lower traffic levels, reduced workloads and productivity gains in 1989 resulted in decreased train operation and maintenance expenses. Non-operating expenses were down mainly from a $76.8 million reduction in interest costs, as well as lower taxes and pensions. Operating expenses in 1988 decreased mainly because of lower equipment maintenance expenses, reduced VIA contract workloads, productivity and other miscellaneous savings from staff reductions. Non-operating expenses were down, due mainly to lower interest, pension and equipment lease costs.

GRAND TRUNK CORPORATION

Grand Trunk Corporation had income of $13.7 million in 1989, up $0.8 million from 1988, but down $8.2 million from 1987. The main factor in the 1989 betterment was increased other income, principally from profit on the sale of Trailer Train stock and from lower interest costs. This improvement was partly offset by reduced income from operations. The inclusion in the 1987 results of non-recurring other income from the sale of two branch lines, investments and other assets was largely responsible for the decline in 1988.

Revenues amounted to $461.3 million in 1989, $477.8 million in 1988 and $486.0 million in 1987. The decline in both 1989 and 1988 was due to the effect of the strengthening Canadian dollar on the conversion of U.S. dollar amounts. In fact, there were year-over-year increases in revenues expressed in U.S. dollars in both 1989 and 1988. Marginal increases in traffic volume coupled with slightly higher freight rates account for the 1989 improvement expressed in U.S. dollars. The corresponding increase in 1988 was due to higher traffic volumes, increased freight rates and improved traffic mix.

Expenses totalled $447.6 million in 1989, $464.9 million in 1988 and $464.2 million in 1987. The $17.3 million improvement in 1989 mainly reflected the strengthening of the Canadian dollar and a charge for employee separation in 1988, the benefits of which were felt mostly in 1989. Expenses in 1988 remained at virtually the same level as 1987 despite separation costs, reduced other income and increased traffic volumes, wage rates and fuel prices. This was due mainly to the strengthening Canadian dollar, employee reductions and lower interest costs.

ENTERPRISES GROUP

CN Exploration

CN Exploration had income of $7.8 million in 1989, $3.1 million in 1988 and $10.6 million in 1987. The 1989 increase was due to higher crude oil prices and a non-recurring gain on the disposal of royalty income properties partly offset by reduced sales volumes. The decrease in 1988 occurred because of declining crude oil prices.

CN Real Estate

Income from CN Real Estate amounted to $93.0 million in 1989, up $46.2 million from 1988 and $55.2 million from 1987. The increase in 1989 was due mainly to a $39.6 million increase in profit on property disposals and a $12.3 million improvement in equity income from joint-development projects, which included property development fees and disposals. The same two factors accounted for the 1988 improvement.

The Company expects the Division's activities, including property disposals and development projects, will continue to be a significant portion of overall operations.

Other

Other Enterprises had income of $17.3 million in 1989, $10.5 million in 1988 and $7.0 in 1987. Increased income from Canac International Inc., CN Communications and CN France accounted for the 1989 improvement. In 1988, higher income from Canac International Inc. and CN Tower was responsible for the increase.

INCOME TAXES

Total income taxes for 1989 have been reduced by the amount of $39.2 million through the utilization of the remainder of the Company's tax benefits pertaining to prior years' losses, which reduction was accounted for as an extraordinary item. The corresponding amount for 1988 was $141.1 million and for 1987, $56.4 million. See Note 3 of Notes to Consolidated Financial Statements.

LIQUIDITY AND CAPITAL RESOURCES

During 1989, cash from operating activities was sufficient to cover capital expenditures and the retirement of long-term debt during the year, as well as improve the net cash position.

At the end of 1989, the Company had cash and short-term deposits of $128.7 million, an increase of $92.5 million in net cash position from the year-end 1988 level. Moreover, the Company has arrangements with a number of Canadian and U.S. banks which provide lines of credit in excess of the Company's anticipated short-term borrowing requirements. During 1989 the Company entered into a conditional sale agreement which had the effect of adding $14.4 million to long-term debt.

The Company repaid $78.3 million in long-term debt in 1989, consisting mainly of contractual obligations and sinking fund requirements. Company indebtedness, comprising long-term debt (including the current portion) and bank indebtedness, less cash and time deposits, decreased from $1,978.7 million in 1988 to $1,801.2 million.

As a result of the debt reduction and an increase in retained earnings, the Company's year-end long-term debt ratio decreased from 37.4% to 35.3%.

Planned capital expenditures for 1990 are approximately $485 million. In addition, the Company anticipates that capital expenditures for 1991 through 1994 will aggregate approximately $2.5 billion, and will include funds required for renewal of the basic plant, purchase of rolling stock and other equipment, real estate development and improvement of operating efficiency. The Company expects that although the major portion of these expenditures will be funded internally, the aggregate of capital expenditures, together with provision for debt maturities in the period, may require further borrowings.

As at December 31, 1989, the Company had commitments to purchase railway ties at an aggregate cost of $21.8 million and rail at a cost of $12.7 million. In addition the Company was committed to suppliers for new locomotives having a value of $59.7 million which are expected to be obtained under lease arrangements.

The accompanying consolidated financial statements of Canadian National Railway System and all information in this annual report are the responsibility of management and have been approved by the board of directors.

The financial statements have been prepared by management in conformity with Canadian generally accepted accounting principles. These statements include some amounts that are based on best estimates and judgments. Financial information used elsewhere in the annual report is consistent with that in the financial statements.

Management of the Company, in furtherance of the integrity and objectivity of data in the financial statements, has developed and maintains a system of internal accounting controls and supports an extensive program of internal audits. Management believes that this system of internal accounting controls provides reasonable assurance that financial records are reliable and form a proper basis for preparation of financial statements and that assets are properly accounted for and safeguarded.

The board of directors carries out its responsibility for the financial statements in this report principally through its audit committee, consisting solely of outside directors. The audit committee reviews the Company's annual consolidated financial statements and recommends their approval by the board of directors. Also, the audit committee meets regularly with the Vice-President Internal Audit and with the Shareholder's Auditors, appointed by the Government of Canada.

These consolidated financial statements have been examined by the Shareholder's Auditors, Touche Ross, whose report is presented below.

Yvon H. Masse.

Yvon H. Masse
Senior Vice-President and
Chief Financial Officer

AUDITORS' REPORT

Touche Ross

To the Minister of Transport
Ottawa, Canada

We have examined the consolidated balance sheets of the Canadian National Railway System as at December 31, 1989 and 1988 and the consolidated statements of income, retained earnings and changes in financial position for each of the years in the three-year period ended December 31, 1989. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the System as at December 31, 1989 and 1988 and the results of its operations and the changes in its financial position for each of the years in the three-year period ended December 31, 1989 in accordance with generally accepted accounting principles applied on a consistent basis.

Touche Ross

CHARTERED ACCOUNTANTS

MONTREAL, QUEBEC
February 20, 1990

Year ended December 31 (in thousands)		1989	1988	1987
CN Rail	Revenues	$3,528,331	$3,792,115	$3,732,294
	Expenses	3,403,307	3,571,430	3,618,546
	Income	125,024	220,685	113,748
Grand Trunk Corporation	Revenues	461,312	477,816	486,044
	Expenses	447,625	464,882	464,197
	Income	13,687	12,934	21,847
Enterprises group:				
CN Exploration	Revenues	30,283	27,568	36,820
	Expenses	22,475	24,428	26,199
	Income	7,808	3,140	10,621
CN Real Estate	Revenues	103,293	56,312	54,102
	Expenses	36,252	22,057	16,505
	Other income	25,949	12,557	205
	Income	92,990	46,812	37,802
Other	Income	17,273	10,471	7,007
Total Enterprises group		118,071	60,423	55,430
Total continuing operations		256,782	294,042	191,025
Discontinued operations:		—	(26,052)	(31,146)
Premium on early extinguishment of long-term debt		—	(111,106)	—
Income before income taxes and extraordinary items		256,782	156,884	159,879
Income taxes		90,241	99,803	76,038
Income before extraordinary items		166,541	57,081	83,841
Extraordinary items*		39,210	225,584	36,741
Net income		$ 205,751	$ 282,665	$ 120,582

**See Note 3*

See accompanying notes to consolidated financial statements.

December 31 (in thousands)			1989		1988
Assets					
Current	Cash and time deposits		$ 128,824		$ 36,286
	Accounts receivable		431,955		416,145
	Material and supplies		251,156		219,152
	Other		270,573		274,136
			1,082,508		945,719
Insurance Fund			7,538		7,675
Investments			106,495		76,088
Properties			5,814,073		5,770,440
Other Assets and Deferred Charges			94,737		106,113
			$7,105,351		$6,906,035
Liabilities					
Current	Bank indebtedness		$ 100		$ 100
	Accounts payable and accrued charges		850,277		806,169
	Current portion of long-term debt		59,990		57,254
	Other		311,092		276,214
			1,221,459		1,139,737
Provision for Insurance			7,538		7,675
Other Liabilities and Deferred Credits			418,094		421,815
Deferred Income Taxes			44,570		—
Long-Term Debt			1,869,889		1,957,608
Minority Interest in Subsidiary Companies			4,345		4,345
Shareholder's Equity	Capital stock	$2,278,867		$2,278,867	
	Retained earnings	1,260,589	3,539,456	1,095,988	3,374,855
			$7,105,351		$6,906,035

See accompanying notes to consolidated financial statements.

On behalf of the board:

Brian R.D. Smith, Director

Ronald E. Lawless, Director

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

Year ended December 31 (in thousands)	1989	1988	1987
Balance, beginning of year	$1,095,988	$ 822,212	$725,746
Prior years' dividends reversed	—	47,644	—
Net income	205,751	282,665	120,582
Dividend	(41,150)	(56,533)	(24,116)
Balance, end of year	$1,260,589	$1,095,988	$822,212

See accompanying notes to consolidated financial statements.

Year ended December 31 (in thousands)		1989	1988	1987
Operating activities:				
Net income		$ 205,751	$ 282,665	$ 120,582
Non-cash charges to income:	Depreciation and amortization	264,766	293,699	293,045
	Loss (income) of equity investees less dividends	(29,255)	(8,402)	1,473
	Gain on disposal of business units	—	(285,113)	(4,900)
	Provision for property impairment	—	62,683	43,075
	Deferred income taxes	44,570	—	—
Changes in working capital items*		34,735	(40,542)	252,674
Other		(32,462)	66,887	38,484
		488,105	371,877	744,433
Investing activities:				
Additions to properties		(370,960)	(386,319)	(482,058)
Net proceeds from disposal of properties		62,560	71,600	67,590
Investments		(23,204)	(15,539)	(6,723)
Proceeds from sale of business units		—	882,283	23,596
Working capital of previously consolidated companies		—	(18,642)	(2,747)
Investments in previously consolidated companies		—	(13,259)	—
		(331,604)	520,124	(400,342)
Cash provided before financing activities		156,501	892,001	344,091
Financing activities:	Issuance of long-term debt	14,381	5,772	19,020
	Reduction of long-term debt	(78,344)	(798,327)	(319,477)
		(63,963)	(792,555)	(300,457)
Net increase in cash		92,538	99,446	43,634
Cash (bank indebtedness), beginning of year		36,186	(63,260)	(106,894)
Net cash (bank indebtedness), end of year		$ 128,724	$ 36,186	$ (63,260)

**Excluding cash, bank indebtedness, and current portion of long-term debt*

See accompanying notes to consolidated financial statements.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Introduction

All references in these Notes to the "Company" refer to Canadian National Railway Company which is wholly-owned by the Government of Canada and, unless the context otherwise requires, its consolidated subsidiaries, and all references to the "System" mean Canadian National Railway Company and its consolidated subsidiaries together with the lines of railway, telecommunications and other property entrusted by the Government of Canada to the Company for management and operation.

a) Principles of Consolidation

The consolidated financial statements include the accounts of all significant subsidiaries and, prior to its disposal in 1988, included the Company's share of the assets, liabilities and income of CNCP Telecommunications which was accounted for by the proportionate consolidation method. Also, consistent with the legislation governing the System, the accounts of the Canadian Government Railways entrusted to the Company by the Government of Canada are included in the consolidated financial statements.

Once a formal plan for the disposition of a significant segment has been adopted, the segment is no longer consolidated but reported under the equity method and included in "Investments" in the consolidated financial statements. The related operating results are reported as results of discontinued operations.

Investments in entities in which the Company has less than a majority interest are accounted for by the equity method, where appropriate.

b) Reporting by Division

In presenting the results by division, interdivisional charges for services have not been eliminated. Consolidated net income is not affected by this practice.

c) Material and Supplies

The inventory is valued at laid down cost based on weighted average cost for ties and rails, latest invoice price for fuel and new materials in stores, and at estimated utility or sales value for usable second hand, obsolete and scrap materials.

d) Insurance Fund

Certain System components are self-insured for various risks, with a separately-invested fund being maintained. The provision for insurance represents the estimated amount of self-insured losses to be settled.

e) Properties

Accounting for railway and telecommunications properties is carried out in accordance with rules issued by the National Transportation Agency of Canada and the Canadian Radio-television and Telecommunications Commission respectively (Canadian properties), and the Interstate Commerce Commission (United States properties). Generally, major additions and replacements are capitalized and interest costs are charged to expense.

The cost of depreciable railway and telecommunications assets retired or disposed of, less salvage, is charged to accumulated depreciation, in accordance with the group plan of depreciation. Other depreciable assets retired or disposed of are accounted for in accordance with the unit plan whereby gains or losses are taken into income as they occur.

The Company follows the successful efforts method of accounting for its oil and gas operations whereby the acquisition costs of oil and gas properties, the costs of successful exploratory wells and the costs of drilling and equipping development wells are capitalized.

CN Real Estate's properties are stated at cost. Carrying costs of properties under development are capitalized. Such costs include real estate taxes, insurance, interest and other expenses directly related to the development activity.

f) Depreciation

Depreciation is calculated at rates sufficient to write off properties over their estimated useful lives, generally on a straight-line basis. For railway and telecommunications properties, rates are authorized by the National Transportation Agency of Canada, the Canadian Radio-television and Telecommunications Commission and the Interstate Commerce Commission. The rates for significant classes of assets are as follows:

	Annual Rate
Ties	2.71%-2.73%
Rails	1.93%
Other track material	2.23%-2.83%
Ballast	3.27%
Road locomotives	4.30%
Freight cars	1.73%-3.18%

Acquisition costs of oil and gas properties are amortized on a straight-line basis over the term of the lease until such time as the properties are determined to be productive or judged to be impaired. Acquisition costs of productive properties and costs of successful exploratory drilling and of drilling and equipping development wells are charged against income on the unit-of-production method based upon proven reserves of oil and gas. Exploratory dry hole and acquisition costs judged to be impaired are charged against income in the current period. Other exploratory expenditures are charged against income as incurred.

CN Real Estate assets are depreciated using the straight-line method calculated over the estimated economic life of the asset.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

g) Revenues

Transportation: Revenues are generally recognized on completion of movements, with interline movements being treated as complete when the shipment is turned over to the connecting carrier. Costs associated with movements not completed are deferred.

Real estate: Rental revenues are recognized as earned. Revenues from disposition of properties are recognized on completion of the sale. The share of income from joint ventures is recognized on an equity basis and reported as Other income.

h) Pensions

Pension costs are determined periodically by independent actuaries. Pension expense is charged annually to operations and comprises the total of the following:

- the cost of pension benefits provided in exchange for employees' services rendered during the year, and
- amortization of past service costs over the expected average remaining service life of the employee group covered by the plans.

The pension plans are funded through contributions determined in accordance with the accrued benefit actuarial cost method.

i) Foreign Exchange

The Company's foreign operations are classified as integrated and are translated and accounted for on the following bases. Current assets (excluding material and supplies), current liabilities and long-term debt are translated at the rates in effect at the balance sheet date, whereas all other assets and liabilities are translated at historical rates. Revenues and expenses are translated at average rates during the year except for depreciation which is translated at exchange rates prevailing when the related properties were acquired.

The Company's own foreign denominated assets and liabilities are accorded similar treatment. Revenues and expenses are translated at rates prevailing at the time of the transactions except for revenues designated as a hedge against repayment of foreign denominated long-term debt which are translated at the rate in effect at the inception of the debt.

Currency gains and losses are reflected in net income for the year, except for unrealized foreign currency losses on long-term debt. The Company has designated future U.S. dollar revenue streams as a hedge against the repayment of most of its long-term debt denominated in U.S. dollars, and has thus deferred reflecting the related unrealized foreign currency translation losses in net income until the earlier of the debt repayment or the expiry of the hedge. Unrealized foreign currency losses related to long-term debt denominated in U.S. dollars not covered by the hedge are deferred and amortized over the remaining life of the debt. Such deferred amounts are included in the Consolidated Balance Sheet as part of Other Assets and Deferred Charges.

j) Leases

Leases which satisfy the criteria for capital leases and which have been entered into after 1981 have been capitalized. Other leases entered into prior to 1982, satisfying the criteria for capital leases, have been recorded as operating leases.

NOTE 2: DISCONTINUED OPERATIONS

Details of discontinued operations are as follows:

	Year ended December 31		
	1989	1988	1987
	(in thousands)		
TerraTransport	$ —	$ (29,277)	$ (41,336)
CN Communications	—	12,362	21,935
CN Hotels	—	(9,137)	(13,113)
Dockyard	—	—	1,368
	$ —	$ (26,052)	$ (31,146)

NOTE 3: EXTRAORDINARY ITEMS

During 1988 the Company disposed of CN Hotels, the two subsidiary telephone companies and CNCP Telecommunications, with the latter sale including Telecommunications Terminal Systems. The Dockyard was disposed of in 1987.

Asset write-downs to reflect impairments also occurred affecting CNCP Telecommunications in 1988 and TerraTransport in 1987.

TerraTransport incurred closure costs in 1988.

The financial effect of these transactions, their effect on the Company's income tax position and the reduction in income taxes on application of prior years' losses are as follows:

	Year ended December 31		
	1989	1988	1987
	(in thousands)		
Net gain on disposal of business units	$ —	$ 285,113	$ 4,900
Less related income tax effect	—	(114,958)	(2,381)
	—	170,155	2,519
Loss on write-down of assets	—	(62,683)	(43,075)
Less related income tax effect	—	28,051	20,933
	—	(34,632)	(22,142)
Closure cost of discontinued operations	—	(92,300)	—
Less related income tax effect	—	41,304	—
	—	(50,996)	—
Reduction in income taxes on application of prior years' losses	39,210	141,057	56,364
	$ 39,210	$ 225,584	$ 36,741

NOTE 4: INVESTMENTS

	Percentage of Voting Interest	*December 31*	
		1989	1988
		(in thousands)	
Entities accounted for by equity method:			
CNCP Niagara-Detroit Partnership	50%	$ 17,766	$ 20,141
The Toronto Terminals Railway Company	50%	10,682	10,682
Other		36,494	18,594
		64,942	49,417
Other companies and investments, at cost less provisions for impairment where applicable		41,553	26,671
Total		$ 106,495	$ 76,088

NOTE 5: PROPERTIES

	December 31, 1989			*December 31, 1988*		
	Cost	Accumulated Depreciation	Net	Cost	Accumulated Depreciation	Net
	(in thousands)			*(in thousands)*		
CN Rail	$8,356,990	$3,172,380	$5,184,610	$8,278,744	$3,099,146	$5,179,598
Grand Trunk Corporation	522,984	144,485	378,499	529,510	144,386	385,124
Enterprises group:						
CN Exploration	114,846	53,368	61,478	103,048	45,325	57,723
CN Real Estate	151,169	18,571	132,598	107,784	17,245	90,539
Other	79,773	22,885	56,888	78,849	21,393	57,456
	$9,225,762	$3,411,689	$5,814,073	$9,097,935	$3,327,495	$5,770,440
Amounts included above with respect to Canadian Government Railways entrusted to the Company by the Government of Canada	$1,019,199	$ 554,399	$ 464,800	$1,026,898	$ 540,718	$ 486,180

At December 31, 1989 the gross value of assets under capital leases included above was $103.7 million (1988 – $108.4 million) and related accumulated amortization thereon amounted to $16.0 million (1988 – $12.1 million).

NOTE 6: LONG-TERM DEBT

			Maturity	Currency in which Payable	December 31 1989	December 31 1988
					(in thousands)	
Bonds, Debentures and Notes						
Canadian National Notes	11⅜%	8 Year	June 11, 1993	Canadian	$ 100,000	$ 100,000
Canadian National Notes	9⅜%	8 Year	Mar. 18, 1994	Canadian	100,000	100,000
Canadian National Notes	12½%	10 Year	Apr. 15, 1995	Canadian	100,000	100,000
Canadian National Japanese Yen Notes (a)	6½%	10 Year	Mar. 26, 1996	Canadian	70,000	70,000
Canadian National Notes	9⅜%	10 Year	Oct. 1, 1996	Canadian	100,000	100,000
Canadian National Sinking Fund Debentures	9¼%	20 Year	Mar. 15, 1998	United States	62,315	80,120
Canadian National Swiss Franc Bonds (b)	5⅜%	15 Year	Aug. 22, 2000	Canadian	98,617	98,617
Canadian National Notes	8⅜%	15 Year	May 21, 2001	Canadian	150,000	150,000
Canadian National Sinking Fund Debentures	8⅜%	25 Year	July 1, 2002	United States	68,858	68,858
Canadian National Sinking Fund Debentures	9.70%	25 Year	July 15, 2004	United States	163,861	165,342
Canadian National Sinking Fund Debentures	13%	20 Year	Nov. 15, 2004	Canadian	90,196	93,464
Canadian National Sinking Fund Debentures	12¼%	20 Year	May 1, 2005	Canadian	125,000	125,000
Canadian National Sinking Fund Debentures	14%	25 Year	Jan. 15, 2006	United States	95,028	106,800
Canadian National Sinking Fund Debentures	15%	25 Year	June 1, 2006	United States	84,328	103,244
Canadian National Sinking Fund Debentures	16¼%	25 Year	Mar. 1, 2007	United States	87,180	98,801
Canadian National Sinking Fund Debentures	14¾%	30 Year	Sept. 1, 2012	United States	55,722	83,930
Canadian National Sinking Fund Debentures	12%	30 Year	Mar. 15, 2013	United States	122,548	122,548
Buffalo & Lake Huron 1st Mortgage Bonds	5½%		Perpetual	Sterling	795	795
Buffalo & Lake Huron 2nd Mortgage Bonds	5½%		Perpetual	Sterling	1,228	1,228
Total Bonds, Debentures and Notes					1,675,676	1,768,747
Government of Canada Loan (c)					161,085	173,432
Other						
Amounts owing under equipment purchase agreements (d)				Various	105,592	116,906
Syndicated loan (e)				Canadian	42,610	42,610
Capital lease obligations (f)				Various	90,733	97,052
Term Loan				United States	—	2,107
Adjustment to current exchange rate (see Note 1 i))					(12,074)	12,885
Total Other					226,861	271,560
					2,063,622	2,213,739
Less: In-substance defeasance (g)					123,545	193,753
Current portion of long-term debt					59,990	57,254
Unamortized discount and other					10,198	5,124
					193,733	256,131
Long-Term Debt					$1,869,889	$1,957,608

a) The Company borrowed $70.0 million at an all-in cost of 10.25% by means of a Euro-yen public note issue and a currency swap.

b) The Company borrowed $98.6 million at an all-inclusive cost of 11.17% by means of a public bond issue in Switzerland and a currency swap.

c) The Government of Canada loan bears interest at 8¼% per annum and is payable in equal semi-annual payments of $13.63 million covering principal and interest to June 30, 1998.

d) Secured by rolling stock and payable by semi-annual or quarterly instalments over various periods to 2000 at interest rates ranging from 8½% to 17¾%. As at December 31, 1989, the principal amounts are payable as U.S. $77.1 million and Canadian $14.4 million (December 31, 1988 - U.S. $101.0 million).

e) The Company borrowed $42.6 million at an all-inclusive cost of 11.535% by means of a yen syndicated loan and currency swap.

NOTE 6: LONG-TERM DEBT (Cont'd.)

f) Interest rates for these leases range from approximately 7⅞% to 14½% with expiry dates occurring during the years 1990 through 2004. The imputed interest on these leases amounts to $79.0 million (1988 - $92.6 million).

g) Certain of the Company's long-term debt is considered to be extinguished as a result of the Company's having placed in irrevocable trusts, government securities sufficient to satisfy the interest and maturing principal requirements of the specific debt obligations involved.

h) Principal repayments, including sinking fund repayments, repurchase arrangements and capital lease repayments, on debt outstanding at December 31, 1989, are as follows:

Year ending December 31:	*(in thousands)*
1990	$ 59,990
1991	70,096
1992	58,455
1993	164,572
1994	166,303
1995-1999	608,680
2000-2004	558,337
2005-2009	167,611
2010-2015	71,205

NOTE 7: SHAREHOLDER'S EQUITY

a) Capital Stock

The capital stock of Canadian National Railway Company, $2,278,866,774, consists of 5,868,786 common shares of no par value authorized, issued and outstanding which are owned by the Government of Canada.

b) Retained Earnings

Under its governing legislation, the Company is required to pay to the Receiver General for Canada a dividend equal to 20% of net income for the year of such greater percentage as the Governor in Council may direct. Accordingly, a dividend representing 20% of the net income for the year, has been accrued and is included in Other Current Liabilities as is the dividend pertaining to 1988 net income. The dividends accrued on 1985 and 1987 income, which had not yet been paid, were reversed and transferred to retained earnings in 1988 on the basis of a Treasury Board of Canada decision dated 15 December 1988.

NOTE 8: MAJOR COMMITMENTS

a) Leases

(i) The Company's commitments as at December 31, 1989, under leases, excluding those which have been capitalized and for which the lease obligations are recorded as long-term debt (see Note 6), are as follows:

Non-Cancellable Leases	Pre-1982 Capital Leases	Operating Leases
Year ending December 31:	*(in thousands)*	
1990	$13,002	$ 113,127
1991	5,609	109,303
1992	4,212	103,683
1993	1,959	104,984
1994	1,501	101,309
1995-1999	4,596	422,052
2000-2004	1,891	309,486
Thereafter	—	90,853
Total minimum lease payments	32,770	$1,354,797
Less amount representing imputed interest	7,625	
Present value of net minimum lease payments under capital leases	$25,145	

A significant portion of the leases is in respect of railway rolling stock and many of them provide renewal options and an option to purchase the property at fair market value at the end of the lease terms.

(ii) Rental expenses under all lease arrangements which have not been capitalized were:

	Year ended December 31		
	1989	1988	1987
	(in thousands)		
Total expenses	$140,628	$154,719	$173,329
Expenses under pre-1982 capital leases included in total expenses	$ 28,027	$ 35,506	$ 43,188

(iii) Increases in income, assets and liabilities in the consolidated financial statements, which would have arisen if leases entered into prior to 1982 and which satisfied the criteria for capital leases had been capitalized, are as follows:

NOTE 8: MAJOR COMMITMENTS (Cont'd.)

	Year ended December 31		
	1989	1988	1987
	(in thousands)		
Net increase in income	$ 9,969	$ 11,810	$ 13,132
Increase in Assets			
Properties			
Leased properties under capital leases	$ 136,675	$ 241,538	$ 246,280
Less accumulated amortization	117,555	210,335	199,660
	19,120	31,203	46,620
Other assets and deferred charges			
Unamortized deferred exchange loss	813	3,671	10,172
	$ 19,933	$ 34,874	$ 56,792
Increase in Current Liabilities			
Present value of obligations under capital leases	$ 10,735	$ 25,964	$ 30,900
Increase in Non-Current Liabilities			
Present value of obligations under capital leases	$ 24,093	$ 47,216	$ 73,726
Adjustment to current exchange rate (see Note 1 i))	1,052	3,925	11,456
	25,145	51,141	85,182
Less current portion	10,734	25,964	30,900
	$ 14,411	$ 25,177	$ 54,282

b) Other

The Company has commitments at December 31, 1989, for capital expenditures of $21.8 million for railway ties and $12.7 million for rail. In addition, the Company at that date was committed to suppliers for new locomotives having a value of $59.7 million, expected to be obtained under lease arrangements.

NOTE 9: SUBSIDIES

Revenues include the following subsidies:

	Year ended December 31		
	1989	1988	1987
	(in thousands)		
Government of Canada			
a) Payments under the Railway Act paid under authority of that Act and the related Appropriation Act in respect of certain uneconomic operations, services and prescribed rates which railways are required by the Railway Act to maintain	$ 32,818	$ 48,854	$ 37,661
b) Maritime Freight Rates Act and Atlantic Region Freight Assistance Act subsidies	17,381	19,971	18,520
c) Sundry	548	2,510	1,884
Other assistance	—	391	134
	$ 50,747	$ 71,726	$ 58,199

NOTE 10: PENSIONS

The Company has retirement benefit plans covering substantially all its employees under which they are entitled to benefits at retirement age generally based on compensation and length of service and/or contributions.

The actuarial valuations as at December 31, 1988, revealed a consolidated actuarial liability of $6.7 billion and a consolidated actuarial asset value of $5.9 billion. It is estimated that those amounts could approximate $7.0 billion and $6.5 billion respectively as at December 31, 1989. Subsequent actuarial valuations will determine the actual values at that date.

Annual pension costs were:

	Year ended December 31		
	1989	1988	1987
	(in thousands)		
	$ 156,552	$ 165,784	$ 200,731

NOTE 11: SYSTEM INTEREST EXPENSE

	Year ended December 31		
	1989	1988	1987
	(in thousands)		
Interest			
Total interest on long-term debt	$ 214,272	$ 318,297	$ 367,142
Interest on short-term borrowings	217	2,431	7,175
Interest income	(15,332)	(20,269)	(2,435)
	$ 199,157	$ 300,459	$ 371,882

NOTE 12: INCOME TAXES

a) The Company's provision for income taxes is made up as follows:

	Year ended December 31		
	1989	1988	1987
	(in thousands)		
Provision for income taxes based on combined basic Canadian federal and provincial tax rate for 1989 of 40.8% (1988 - 44.7%, 1987 - 48.6%)	$ 104,870	$ 70,206	$ 77,701
Increase (decrease) in taxes resulting from:			
Non-allowable portion of capital loss on early extinguishment of debt	—	17,670	—
Capital losses not allowed for current year	—	12,726	—
Non-allowable foreign exchange loss on conditional sale agreements	414	686	1,347
Profit on sale of land	(22,858)	(6,060)	(6,785)
Federal large corporations tax	4,000	—	—
Other	3,815	4,575	3,775
Actual provision for income taxes resulting in an effective tax rate for 1989 of 35.1% (1988 - 63.6%, 1987 - 47.6%)	$ 90,241	$ 99,803	$ 76,038

b) The following provides a summary of income tax balances:

Annual provision	$ 90,241	$ 99,803	$ 76,038
Extraordinary items:			
Disposal of business units	—	114,958	2,381
Writedown of assets	—	(28,051)	(20,933)
Closure of discontinued operation	—	(41,304)	—
Application of prior years' losses	(39,210)	(141,057)	(56,364)
Net tax expense	$ 51,031	$ 4,349	$ 1,122
Payable in current year	$ 6,461	$ 4,349	$ 1,122
Deferred to future years	$ 44,570	$ —	$ —

Deferred income taxes result primarily from the difference between capital cost allowance claimed for income tax and depreciation recorded for accounting purposes.

c) Investment tax credits are also available to reduce future income taxes otherwise payable until the related year of expiry:

Year of Expiry	(in millions)
1993	$25.9
1994	$33.9
1995	$29.7
1996	$18.9
1997	$14.0
1998	$ 9.0

NOTE 13: SEGMENTED INFORMATION

a) Geographic Areas

Virtually all of the System's operations and assets are within Canada with the exception of Grand Trunk Corporation which operates in the United States.

b) International Traffic

In addition to the revenue generated by Grand Trunk Corporation, the System derives revenue from traffic originating or terminating on railroads in the United States. In 1989, such revenues approximated $622 million (1988 - $668 million, 1987 - $612 million).

c) Revenues by Division

	Year ended December 31		
	1989	1988	1987
	(in thousands)		
CN Rail	$3,528,331	$3,792,115	$3,732,294
Grand Trunk Corporation	461,312	477,816	486,044
Enterprises group:			
CN Exploration	30,283	27,568	36,820
CN Real Estate	103,293	56,312	54,102
Other	80,301	56,004	40,783
Discontinued operations:			
TerraTransport	—	1,459	4,259
CN Communications	—	236,884	296,250
CN Hotels	—	26,524	135,010
	$4,203,520	$4,674,682	$4,785,562

d) Identifiable Assets by Division

CN Rail	$6,143,025	$6,006,443	$6,203,938
Grand Trunk Corporation	591,993	611,912	623,715
Enterprises group:			
CN Exploration	70,288	65,239	67,157
CN Real Estate	218,216	141,140	93,603
Other	81,829	81,301	77,685
Discontinued operations:			
TerraTransport	—	—	9,874
CN Communications	—	—	517,677
	$7,105,351	$6,906,035	$7,593,649

e) Capital Expenditures and Depreciation by Division

	Capital Expenditure*			Depreciation		
	Year ended December 31			*Year ended December 31*		
	1989	1988	1987	1989	1988	1987
	(in thousands)					
CN Rail	$ 293,816	$ 283,723	$ 355,146	$ 239,020	$ 234,794	$ 211,045
Grand Trunk Corporation	18,194	14,370	12,554	14,494	14,157	14,473
Enterprises group:						
CN Exploration	13,302	9,868	9,147	8,138	9,798	10,723
CN Real Estate	44,487	28,560	17,981	1,419	1,102	1,027
Other	1,161	185	340	1,696	1,880	1,937
Discontinued operations:						
TerraTransport	—	—	589	—	—	2,461
CN Communications	—	49,613	68,094	—	31,789	45,085
CN Hotels	—	—	18,207	—	—	6,023
	$ 370,960	$ 386,319	$ 482,058	$ 264,767	$ 293,520	$ 292,774

* Represents additions to properties.

NOTE 14: OTHER MATTERS

a) The Company carries on ordinary business transactions with various entities controlled by the Government of Canada on the same terms and conditions as current transactions with unrelated parties.

In addition, the Company provides, under contractual arrangements, rail transportation and maintenance services to the Government of Canada and to entities controlled by the latter. The revenue derived from such services rendered in 1989 aggregated $101.5 million (1988 - $103.3 million, 1987 - $148.2 million).

b) Following enactment of the Western Grain Transportation Act, which became effective on January 1, 1984, the Government of Canada, in order to minimize the cost to grain shippers, pays a portion of the cost of shipping grain. Amounts received from the Government of Canada under the Western Grain Transportation Act amounted to $332.6 million in 1989 (1988 - $416.0 million, 1987 - $435.3 million), a reflection of the volume of grain handled.

c) Commencing in 1977, the Government of Canada has agreed to pay to the Company, by way of capital grants not exceeding $557.9 million, certain amounts with respect to expenditures incurred in carrying out rehabilitation programs for branch lines in Western Canada. Total payments received up to December 31, 1989, amounted to $469.8 million of which $0.5 million was received in 1989 (1988 - $12.3 million, 1987 - $25.6 million).

NOTE 15: RECLASSIFICATION OF COMPARATIVE FIGURES

During 1989, changes were made to improve the classification of certain items and for comparative purposes the 1988 and 1987 figures have been reclassified.

INDEX

41	GENERAL REVIEW
42	CONSOLIDATED STATEMENT OF NET ASSETS
42	AUDITORS' REPORT
43	CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS
43	ACTUARY'S REPORT
44	NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Improvements in Pension Benefits

In 1989, the Company and all the unions negotiated a pension indexation formula which provides for an annual guaranteed minimum increase for all eligible retirees and surviving spouses effective January 1, 1990. This commitment increased the Actuarial Liability by $264 million and the Company's 1989 contributions by approximately $32 million. In addition, effective January 1, 1989, 50% of the experience gains or losses related to pensioners will be accounted for separately and these net experience gains will be used, starting January 1, 1991, exclusively to pay for indexation of pensions above the minimum up to the maximum annual amount. The maximum annual indexation to eligible retirees and survivors is 50% of the increase in the Consumer Price Index (CPI) to a maximum increase in CPI of 6% with an annual limit on the amount of pension which can be indexed. The basic eligibility requirements to qualify for indexation are to have been retired for five complete years and to have reached age 65.

The year 1989 was also the third year of the Company's four year program of increased pension payments for pensioners. Approximately 36,000 retirees and survivors benefited from such increases for life, the actuarial value of which amounted to about $42 million.

Also, as a result of the last round of negotiations, the Company has agreed to reduce the eligibility requirements for a disability pension effective January 1, 1989. This increased the Actuarial Liability by $23 million and the Company's 1989 contributions by about $4 million.

Direct Deposit – A Useful Service to Pensioners

More and more retirees and survivors are taking advantage of the Direct Deposit System (DDS) which is available free of charge to all retirees and survivors. Under that system the monthly pension benefit is deposited directly in the individual's personal account and an itemized pension pay stub is sent to the beneficiary. Approximately 34,000 beneficiaries used the Direct Deposit System in 1989, an increase of about 75% over 1988.

CONSOLIDATED STATEMENT OF NET ASSETS

As at December 31 (in thousands)	1989	1988
Bonds – quoted market value 1989 – $2,752,571 1988 – $2,165,260	$2,626,634	$2,084,902
Mortgages	177,340	184,244
Real estate	436,967	339,803
Oil and gas	160,693	135,871
Equities – quoted market value 1989 – $3,030,920 1988 – $2,476,531	2,040,801	1,856,183
Accounts receivable – Canadian National Railways	7,221	7,460
Cash and short-term investments	254,813	972,128
	5,704,469	5,580,591
Less: Other net liabilities	37,039	195,789
	$5,667,430	$5,384,802

See accompanying notes to consolidated financial statements.

AUDITORS' REPORT

To The Minister of Transport,
Ottawa, Canada

We have examined the Consolidated Statement of Net Assets of the Canadian National Railways Pension Trust Fund as at December 31, 1989 and the Consolidated Statement of Changes in Net Assets for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Canadian National Railways Pension Trust Fund as at December 31, 1989 and the results of its operations for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Also, in our opinion, proper books of account have been kept and the transactions that have come under our notice have been within the powers of the Trustee.

Mallette, Benoit, Boulanger, Rondeau & Associés

Mallette, Benoit, Boulanger, Rondeau & Associés
Chartered Accountants
Montreal, February 19, 1990

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS

Year ended, December 31 (in thousands)	1989	1988
Net assets, beginning of year	$5,384,802	$5,216,197
Net investment income	520,082	558,432
Contributions by employees	86,014	87,353
Contributions by Company	157,033	167,265
Total additions	763,129	813,050
Pension benefits paid	438,361	410,179
Refunds	26,294	17,140
Total deductions	464,655	427,319
Net increase before transfers	298,474	385,731
Transfers	15,846	217,126
Net increase	282,628	168,605
Net assets, end of year	$5,667,430	$5,384,802

On behalf of the board:

Brian R.D. Smith, Director

Ronald E. Lawless, Director

ACTUARY'S REPORT

To the Trustee
Canadian National Railways Pension Trust Fund

We have conducted actuarial valuations as at December 31, 1988 for the CN Pension Plan and the CN 1935 Pension Plan. These valuations are in accordance with generally accepted actuarial principles and the Recommendations of the Canadian Institute of Actuaries.

As at December 31, 1988, these valuations revealed a consolidated actuarial liability of approximately $6.7 billion, a consolidated unfunded actuarial liability of approximately $0.8 billion and required consolidated Company contributions, for 1989, of $157 million. The next actuarial valuations will be conducted as at December 31, 1991 at the latest.

In my opinion,

- the data on which these valuations were based were sufficient and appropriate for purposes of the valuations;
- the assumptions used were adequate and appropriate for purposes of the valuations; and
- the methods employed in the valuations were consistent with sound actuarial principles.

Bernard Morency.

Bernard Morency
Fellow of the Canadian Institute of Actuaries

William M. Mercer Limitée
Montreal, February 9, 1990

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Principles of Consolidation

The consolidated financial statements include the accounts of the Canadian National Railways Pension Trust Fund and its wholly-owned companies and encompass the 1935 Pension Plan and the CN Pension Plan. These plans under which benefits are generally based on compensation and length of service and/or contributions cover substantially all employees of the Canadian National Railway System.

b) Investment Valuation

(i) Bonds are carried at their amortized cost less deferred amounts arising from exchanges; these amounts are written off over the remaining life of the bonds sold;

(ii) Mortgages are carried at outstanding principal balances and are secured by real estate;

(iii) Real estate consists of land, buildings, and equities. Land is carried at the lower of cost and net realizable value less encumbrances, buildings at the lower of cost and net realizable value less encumbrances and accumulated depreciation calculated using the sinking fund method, and equities amounting to $241.0 million in 1989 (1988 – $177.0 million) at cost. The quoted market value of these real estate equities was $346.4 million as at December 31, 1989 (December 31, 1988 – $242.7 million);

(iv) Oil and gas properties are carried at cost as determined by the full cost method less depletion;

(v) Equities and short-term investments are carried at cost;

(vi) The quoted market value of investments in bonds and equities is based on the closing market quotations as of December 31.

c) Determination of Contributions by the Company

In respect of the 1935 Pension Plan and the CN Pension Plan, the contributions by the Company are determined in accordance with the requirements of the Pension Benefits Standards Act (1985) and regulations thereunder and are based on the accrued benefit actuarial cost method using a projection of salary. Consistent with the regulations and in addition to the current service contribution, the Company is making quarterly special payments to liquidate the unfunded liability by 2006. Also, in the case of the 1935 Pension Plan, the Company makes contributions as determined by the rules of the plan.

In the latest actuarial valuations, the principal assumptions adopted by the Plans' actuary for purposes of the actuarial computations are members' mortality, disability, retirement, termination of employment, merit and periodic increases in earnings, as well as a long-term rate of return of 7.5% per annum on investments. Future increases in members' earnings have been projected using economic assumptions consistent with this long-term rate of return.

d) Accounting for Contributions

Contributions from employees are recorded in the period in which the Company makes payroll deductions. The contributions from the Company as determined by the latest actuarial valuations are recorded using the accrual method.

e) Income Determination

Dividend income is recorded as of the ex-dividend date. Income from other investments is recorded as earned on an accrual basis.

Gain or loss on sales of equities is based on the average cost.

f) Foreign Exchange

Investments denominated in foreign currencies other than short-term investments are translated at historical rates of exchange. Short-term investments and the quoted market value of investments denominated in foreign currencies are translated at current rates. Foreign dividends and interest income are translated at the rates prevailing when received.

g) Transfers

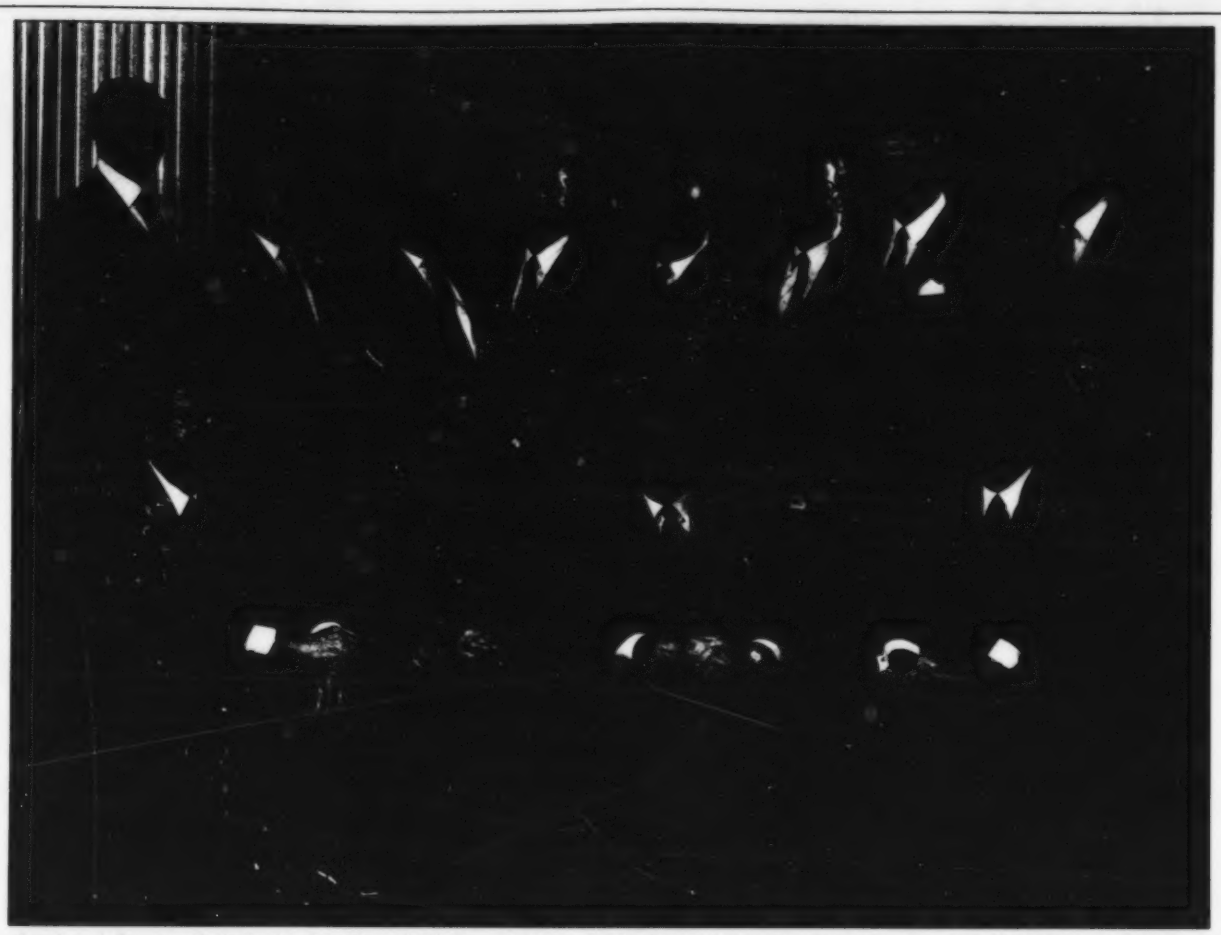
Transfers to/from other funds are accounted for in the period in which the value of the transfers can be reasonably estimated.

NOTE 2: TRANSFERS

In 1989, the accounts include a provision for the amounts to be remitted to/from other funds to cover all transfers of CN employees to other parties and employees of other funds transferred to CN.

NOTE 3: LATEST ACTUARIAL VALUATIONS

The latest actuarial valuations for the 1935 Pension Plan and the CN Pension Plan were as at December 31, 1988 and were submitted to the Superintendent of Financial Institutions and Revenue Canada. The consolidated actuarial liability and the consolidated actuarial unfunded liability resulting from these valuations amounted to approximately $6.7 billion and $0.8 billion respectively. Also, a market related method was used to value the assets for purposes of the actuarial valuations. This method resulted in a consolidated actuarial asset value which was adjusted to market by recognizing realized and unrealized gains over a period of five years using the straight line method. The consolidated actuarial asset value was approximately $5.9 billion as at the date of the latest actuarial valuations.



Standing: J. Brouwer, G. Coulombe, E.A. Mascoll, F.J. Ryan, Y. Poitras, G.T.H. Cooper, A.J. Bentley, E. Demkiw. Seated: B. O'N. Gallery, J. Johnson, R.E. Lawless, B.R.D. Smith

B.R.D. Smith, Q.C.
Chairman
Victoria, British Columbia
(2)
Appointed November 15, 1989

A.J. Bentley
Saskatoon, Saskatchewan
(3) (4)

J. Brouwer
West Vancouver,
British Columbia
(2)

G.T.H. Cooper, Q.C.
Halifax, Nova Scotia
(1) (3)

G. Coulombe
Montreal, Quebec
(1) (3) (4)

E. Demkiw
Vegreville, Alberta
(2) (3) (4)

B. O'N. Gallery
Vice-Chairman
Westmount, Quebec
(3)
Appointed November 15, 1989.
Resigned as member of the Board and as Vice-Chairman February 1, 1990.

J. Johnson
Winnipeg, Manitoba
(2) (3) (5)

R.E. Lawless
President and Chief
Executive Officer
Beaconsfield, Quebec
(2) (3)

E.A. Mascoll
Toronto, Ontario
(2) (4)

Y. Poitras
St. Quentin,
New Brunswick
(1) (4) (5)

F.J. Ryan
St. John's, Newfoundland
(1) (5)
Appointed October 12, 1989

C.J. Stagg
end of term
October 12, 1989

(1) Member of the Audit Committee

(2) Member of the Compensation Committee

(3) Member of the Investment Committee

(4) Member of the Real Estate Committee

(5) Member of the Social Policy Committee

B.R.D. Smith, Q.C.
Chairman

R.E. Lawless
President and Chief Executive Officer

M.A. Blackwell
Vice-President
Atlantic Region

R. Boudreau, Q.C.
Vice-President - Law

F.D. Campbell
Vice-President
Prairie Region

T. Cedraschi
President and Chief Executive Officer
CN Investment Division

G.C. Church
Treasurer

P.A. Clarke
Senior Vice-President
Marketing

A.E. Deegan
Vice-President
Great Lakes Region

M.L. De Pellegrin
President and Chief Executive Officer
Canac International Inc.

B.E. Ducey
Vice-President
Public Affairs and Advertising

J.H. Easton
President and General Manager
CNM Inc.

P.J. Foliot
Vice-President
Purchases and Materials

A.J. Gillies
Vice-President
Intermodal

B.E. Horsman
Vice-President
Planning and Co-ordination

J.P. Kelsall
Senior Vice-President
Operations

J.R. Lagacé
Vice-President
St. Lawrence Region

J.P. Laroche
Vice-President
Employee Relations

G.L. Maas
President
Grand Trunk Corporation

I.G. MacDonald
Vice-President
Financial Planning

D.P. MacKinnon
Vice-President and Secretary of the Company

G. Maroulis
Vice-President
Internal Audit

Y.H. Masse
Senior Vice-President and Chief Financial Officer

R.D. McGrath
Vice-President
Accounting and Comptroller

W.H. Morin
Group Vice-President

A.R. Pozniak
Vice-President
Information Systems

G.R. Snowdon
Acting President
CN Communications

J.H.D. Sturgess
Senior Vice-President and Chief Operating Officer

H.D. Tipple
President
CN Real Estate

D.E. Todd
Vice-President
Government Affairs

W.H. Waddell
President
CN Exploration Inc.

R.A. Walker
Senior Vice-President
Western Canada

Companies included in the Consolidated Financial Statements of the Canadian National Railway System as at December 31, 1989

Consolidated Companies

Autoport Limited

Canac International Inc.

Canac International Ltd.

The Canada and Gulf Terminal Railway Company

Canadian National Express Company

Canadian National Railway Company

The Canadian National Railways Securities Trust

Canadian National Steamship Company, Limited

Canadian National Telegraph Company

Canadian National Transfer Company Limited

Canadian National Transportation, Limited

The Canadian Northern Quebec Railway Company

Canat Limited

Canaven Limited

Central Vermont Railway, Inc.

Chapman Transport Limited

CN Exploration Inc.

C.N. (France) S.A.

CNM Inc.

CN Tower Limited

CN Transactions Inc.

Domestic Four Leasing Corporation

Domestic Three Leasing Corporation

Duluth, Winnipeg and Pacific Railway Company

E I D Electronic Identification Systems Ltd.

Empire Freightways Limited

Grand Trunk Corporation

Grand Trunk Land Development Corporation

Grand Trunk Radio Communications, Inc.

Grand Trunk Western Railroad Company

The Great North Western Telegraph Company of Canada

The Minnesota and Manitoba Railroad Company

The Minnesota and Ontario Bridge Company

Mount Royal Tunnel and Terminal Company, Limited

The Northern Consolidated Holding Company Limited

The Quebec and Lake St. John Railway Company

Royal Transportation Limited

Jointly-operated and other companies in which the System has investments

The Belt Railway Company of Chicago

The Canada Southern Railway Company

Canaprev Inc.

Chicago and Western Indiana Railroad Company

Compagnie de gestion de Matane Inc.

Detroit River Tunnel Company

Dome Consortium Investments Inc.

Domestic Two Leasing Corporation

Eurocanadian Shipholdings Limited

Fort Point Holdings Ltd.

Halifax Industries (Holdings) Limited

Halterm Limited

Lakespan Marine Inc.

Portage & Main Development Ltd.

The Public Markets, Limited

Railroad Association Insurance, Ltd.

Seabase Limited

Shawinigan Terminal Railway Company

Société du port ferroviaire de Baie Comeau-Hauterive

Telesat Canada

The Toronto Terminals Railway Company

Trailer Train Company

In addition, the property of the Canadian Government Railways is entrusted to the Canadian National Railway Company as part of the System.

CN extends its special thanks to all those in our customer companies who collaborated in this report:

General Motors of Canada Limited	Dave Collins Nick Hall Marc Osborne Oshawa, Ontario
Kraft General Foods Canada Inc.	Bill Hozy Toronto, Ontario Dave Mitchell Saint-Laurent, Quebec
Ontario Hydro	Carol Caden Susan Caiger-Watson Toronto, Ontario
Kimberly-Clark Canada Inc.	Sharon Czapary Harvey Jones Louise Plant Toronto, Ontario René St-Hilaire Saint-Hyacinthe, Quebec
Esso Petroleum Canada	Prahda Khamma Linda Scott Toronto, Ontario
Noranda Sales Corporation Ltd.	Daniel St-Louis Ted Zier Vogel Toronto, Ontario Jérôme MacDonald Bathurst, New Brunswick
Weldwood of Canada Limited	Donna Greenwell Carla Nicholl Vancouver, British Columbia Dave Lovely Squamish, British Columbia
Pioneer Grain Company Ltd.	Kim Shukla Winnipeg, Manitoba